IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 79-231

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY,
Petitioner,

v.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, and JOHN E. BRYSON, VERNON L. STURGEON, RICHARD D. GRAVELLE, CLAIRE T. DEDRICK and LEONARD M. GRIMES, JR., the members of said Public Utilities Commission; W. MICHAEL BLUMENTHAL, Secretary of the Treasury, an agency of the United States of America; and JEROME KURTZ, Commissioner, Internal Revenue Service, an agency of the United States of America; CITY OF LOS ANGELES, a municipal corporation; CITY OF SAN DIEGO, a municipal corporation; CITY AND COUNTY OF SAN FRANCISCO, a municipal corporation; TOWARD UTILITY RATE NORMALIZATION, *Respondents.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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Petitioner, The Pacific Telephone and Telegraph Company, respectfully prays that a writ of certiorari issue to review the decision of the United States Court of Appeals for the Ninth Circuit entered on July 18, 1979, upholding the judgment of the District Court in which that Court found Petitioner had "met the requirements for the issuance of injunctive relief" but declined to issue a preliminary injunction solely on the ground of res judicata.

OPINIONS BELOW

The order of the District Court, including findings of fact and conclusions of law, is not reported (App. p. 17a). The opinion of the Court of Appeals is not reported (App. p. 1a).

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254.

QUESTIONS PRESENTED

1. Does the action of the California Supreme Court in declining to grant certiorari without opinion thereby letting stand the state regulatory commission's construction of the federal Internal Revenue Code which is in direct conflict with a ruling of the Internal Revenue Service, preclude a federal court under the doctrine of res judicata from construing the same provisions of the Internal Revenue Code and granting preliminary injunctive relief where it finds: (1) the Petitioner will suffer irreparable injury if the state's construction of the federal statute is erroneous, and (2) that Petitioner has "met the requirements for the issuance of injunctive relief"?

2. Is the failure of the court of equity to provide a remedy for Petitioner—so that both the State of California and the United States would be bound to a consistent interpretation of the Internal Revenue Code—at odds with the objectives of Congress in establishing the tax incentive program and a violation of the due process clause of the Fifth Amendment to the United States Constitution?

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Fifth and Fourteenth Amendments to the United States Constitution; 28 U.S.C. § 1738; pertinent provisions of the Internal Revenue Code of 1954 (26 U.S.C. §§ 46(f), 167(a), 167(*l*)); and Article VI, Section 14 of the California Constitution are reprinted in the Appendix pp. 57a-66a.

STATEMENT

In 1969, 1971, and 1975, Congress established programs to assist regulated utilities through tax benefits created by the deferral and forgiveness of federal taxes through the use of accelerated methods of depreciation and the investment tax credit.[1] For utilities such as Petitioner, Congress provided that eligibility for the tax benefits would be dependent upon the regulatory commission using accounting methods in setting the utility's rates that meet the requirements specified in the Internal Revenue Code and Treasury Regulations. I.R.C. §§ 46(f) and 167(*l*)(3)(G).

Petitioner, in accordance with assurances as to eligibility from the California Public Utilities Commission, has claimed the tax benefits on its federal income tax returns since 1970. By a Decision ("the Decision") in September 1977 the Commission construed the Internal Revenue Code as permitting a change from the accounting procedure theretofore used, which clearly preserved eligibility for the tax benefits, to newly invented

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[1] Tax Reform Act of 1969, Pub.L. No. 91-172, § 441(a), 83 Stat. 625 (1969); Revenue Act of 1971, Pub. L. No. 92-178, § 105(c), 85 Stat. 503 (1971); Tax Reduction Act of 1975, Pub.L. No. 94-12, § 301(a), 89 Stat. 26 (1975).

methods of setting rates designed to flow-through an additional portion of the utility's tax subsidy to the ratepayers by reducing rates. The Commission's action was retroactive to August, 1974 and thus affects eligibility for the tax benefits from that date forward because Petitioner's tax returns are open from 1974 forward. The Commission held that the "maintenance of eligibility under the federal tax laws . . . is an important goal" of the Decision and that its methods of accounting complied with the Internal Revenue Code (App. p. 117a, 119a-120a).

Subsequently the Internal Revenue Service ruled that if effectuated the Decision will destroy Petitioner's eligibility for the tax benefits and has expressed its intent to collect from Petitioner more than one billion dollars ($1,000,000,000) in back taxes and interest which the Commission, as the predicate for its Decision, held were deferred or forgiven.

Under the California procedure, review of Commission action is by writ of certiorari which is discretionary with the California Supreme Court. That Court declined to grant its writ as to the Decision. The California court's action is not reported in the bound reports but was noted in the advance sheets at 21 Cal.3d, Official Advance Sheets, No. 21, minutes p. 3 (1978). The Court's order did not express reasons for its action (App. p. 71a, 72a). Petitioner sought certiorari from this Court and the Solicitor General supported the petition. This Court denied the petition (two Justices voting to grant it) on December 11, 1978, *Pacific Telephone and Tel Co.* v. *PUC,* Docket No. 78-606, —— U.S. ——, 58 L.Ed.2d 713 (1978), and denied rehearing on February 21, 1979.

Petitoner thereafter requested the Commission to examine the I.R.S. rulings, which had been issued subsequent to the Decision, recognize that the Commission's construction of the federal tax law was in error and not implement the Decision until this risk of error could be eliminated by litigation with the I.R.S. This request had two aspects: (1) suspension as to the past period covered by the Decision and (2) suspension of its future application. When the Commission, which had stayed the Decision subject to its further order, on March 14, 1979, directed implementation of the Decision without waiting for litigation with the I.R.S. to settle the tax-eligibility question and without avoiding the continuous accrual of the tax liability, Petitioner brought the action below.

The Complaint is in two alternative counts (App. p. 22a). Count I seeks to restrain implementation of the Decision until after litigation in the normal manner[2] with the I.R.S. to determine the tax eligibility issue. In the alternative, Count II requests a declaratory judgment as to eligibility for the tax benefits. The United States is a party to the second count; the Commission is joined under both counts. The federal statute of limitations will run on the 1974 tax year, which is the first year in issue under the Decision, on September 30, 1979. The I.R.S. has indicated it will protect its position by asserting a tax deficiency before that date.

Petitioner sought a preliminary injunction under Count I. The District Court, after hearing the application for the preliminary injunction, found that Pe-

[2] When the I.R.S. issues a notice of deficiency, the taxpayer may contest the matter in the Tax Court or pay the deficiency and sue to recover the tax in the District Court or Court of Claims.

titioner faced "irreparable injury" if the Decision destroyed the federal tax-eligibility and Petitioner had "met the requirements for the issuance of injunctive relief" (App. p. 20a). But the District Court declined to issue the preliminary injunction on the sole ground that the California Supreme Court's action in refusing (without opinion) to grant certiorari to review the Decision of the Commission was res judicata (App. p. 20a).

The Court of Appeals granted a temporary injunction while it reviewed the District Court's action. On July 18, 1979, the Court of Appeals affirmed the District Court, also solely on the ground of res judicata (App. pp. 4a, 15a).

The federal government has delegated to the state regulator the ability to create or destroy the federal tax subsidy provided by Congress for the private utility. This is because eligibility is dependent upon the manner in which rates are established by the regulator. But the state has not been given the power to determine in a binding fashion whether its action is in accordance with the Internal Revenue Code; that power remains in the federal courts in litigation between the taxpayer and the I.R.S.

The Commission's action was expressly limited to determining the methods that would be used in light of its power, granted by Congress, to control Petitioner's federal tax eligibility. The Commission reviewed the federal law and held

> "Eligibility is the first issue to be determined. To render a decision which attempts to resolve these cases without regard for this issue might create problems for these utilities, their ratepayers, the Commission, and the Courts that even exceed (both in scope and complexity) the problems that we are attempting to resolve in this decision. In the final analysis a loss of eligibility to the utilities would not only create service problems (though certainly not of the scope described by Pacific's) but would create staggering financial problems to be ultimately borne by the ratepayers whose interests we are attempting to redress. We believe that eligibility for these tax benefits should be maintained and proceed on this basis." (App. p. 92a)

The only reason Petitioner faces irreparable injury if the Decision is placed in effect is the probability that the state Commission's construction of the federal Internal Revenue Code is erroneous and, if effectuated, will impose on Petitioner [3] a back tax liability in excess of one billion dollars ($1,000,000,000). That liability is growing at a rate of twenty-two million dollars ($22,000,000) per month. (App. pp. 48a, 55a). The effect of the holding below is that the state's interpretation of the federal law, which can only be tested with the I.R.S. in the federal courts, was binding on the federal judiciary in this action.

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[3] Petitioner is forced by the Commission's economic pressure to claim the tax benefits, for the Commission previously held that if Petitioner failed to claim accelerated depreciation, it would nevertheless impute the tax benefits for ratemaking purposes. Re *Pacific Tel. & Tel. Co.*, 69 Cal.P.U.C. 53, 77 P.U.R.3d 1 (1968).

REASONS FOR GRANTING THE WRIT

I

The Judgment Below Is In Conflict With Decisions of This Court and With the Judgments of Other United States Courts of Appeals and With the Rulings of Other Panels of the Ninth Circuit Court of Appeals

The sole question resolved below is that the Decision of the California Public Utilities Commission on the question of Petitioner's federal tax liability must be treated as an estoppel against the consideration of that federal tax question in subsequent litigation in the appropriate federal district court. It must be conceded that the question of estoppel by state court judgment of a question of federal law which is entrusted by Congress to the jurisdiction of the federal courts is in some disarray. But it cannot be gainsaid that the question is a most important one in the administration of the federal courts and demands elucidation by this Court for the guidance of the lower federal courts.

A. This Court's decisions

In *Brown* v. *Felsen,* —— U.S. ——, 60 L.Ed.2d 767 (1979), this Court held that because of the peculiarly federal interest expressed by Congress in bankruptcy matters, the question whether a claim was fraudulent, which had already been the subject of judgment in the state court, should not be treated by the federal court as foreclosed by the state court judgment. Exclusive jurisdiction over such question was vested in the federal courts and they were not to be bound by prior adjudications. The paramount interest and exclusive jurisdiction of the federal courts in the resolution of the tax questions raised below calls for a similar treatment, allowing the tribunal charged by Congress with the resolution of such questions to do so unhampered by the rulings of a state utility commission, particularly when the utility commission's ruling is in direct conflict with a ruling of the Internal Revenue Service on the exact facts in issue before the commission.

In *Will* v. *Calvert Fire Ins. Co.,* 437 U.S. 655 (1978), Mr. Justice Brennan, speaking in dissent on behalf of four members of the Court, indicated that the question of estoppel in such circumstances was "an unresolved and difficult issue," *id.* at 674, but he said, *ibid*:

> "For myself, I confess to serious doubt that it is ever appropriate to accord res judicata effect to a state court determination of a claim over which the federal courts have exclusive jurisdiction; for surely state court determinations should not disable federal courts from ruling *de novo* on purely legal questions surrounding such federal claims."

B. Lower federal court decisions

The proposition announced by Mr. Justice Brennan, in *Will* v. *Calvert, supra,* bears the label "the *Lyons* doctrine" in the lower federal courts after Judge Learned Hand's decision in *Lyons* v. *Westinghouse Electric Co.,* 222 F.2d 184 (2d Cir. 1955), *cert. denied,* 350 U.S. 825 (1955). The decision below is in conflict with this decision of the Second Circuit and also with the pronouncements of other Courts of Appeals as well.

Thus, Judge Wisdom, speaking for the Court of Appeals for the Fifth Circuit, in *American Mannex Corp.* v. *Rozands,* 462 F.2d 688, 690 (5th Cir. 1972), *cert. denied,* 409 U.S. 1040 (1972): ". . . federal tax policy may dictate limited application of collateral

estoppel when there is federal litigation of a state court determination bearing on federal tax liability." The Sixth Circuit, in *Cream Top Creamery* v. *Dean Milk Co.,* 383 F.2d 358 (6th Cir. 1967), denied estoppel to a state court judgment so far as it concerned a claim cognizable exclusively in the federal courts.

Indeed, until the decision below, the *Lyons* doctrine was recognized in the Ninth Circuit itself. See *In re Houtman,* 568 F.2d 651 (9th Cir. 1978); *Red Fox* v. *Red Fox,* 564 F.2d 361 (9th Cir. 1977). The court below did not acknowledge the existence of the decisions of this Court, those of the other circuits, or even those of its own circuit in applying the doctrine of res judicata to the state commission's ruling on the federal tax question in the face of the I.R.S. ruling to the contrary.

It is not, of course, our contention that there has been uniformity among the lower federal courts except for the Ninth Circuit on this question. As the Court of Appeals for the District of Columbia said recently in *New York St. Teamsters, Etc.* v. *Pension Ben.,* 591 F.2d 953, 956-957 (D.C.Cir. 1979):

> "The decision in *Lyons* has received a mixed response from legal commentators, *compare* 1B J. Moore, Federal Practice § 0.445 at 4113-14 (2d ed. 1974) *with* Developments in the Law: Section 1983 and Federalism, 90 Harv. L. Rev. 1133, 1335 n. 20 (1977), and a number of courts have refused to follow it."

The inconsistency of judgments was also noted by Judge Wisdom in *Mannex, supra,* 462 F.2d at 690 n.2.

Res judicata should not have been applied without any analysis of whether doing so would achieve the

goals of the doctrine and whether there are federal interests present that militate against its application. In the instant case the res judicata interests—the provision of a stopping point for litigation, avoidance of double recovery, stability of judgments—cannot be achieved because the key tax-eligibility question must be litigated again with the I.R.S. and the impact of the loss of eligibility will undermine the prior regulatory action. On the other side, the federal interest in uniformity and clarity in federal tax law is very strong. And as Judge Ely pointed out for a different panel of the Ninth Circuit in *Red Fox* v. *Red Fox, supra,* 564 F.2d at 365 n.4, "When there is a strong interest in providing a federal forum, as here, the availability of Supreme Court review as a check on state court determinations of federal rights is inadequate to satisfy such policy. . . . And, of course, the Supreme Court's heavy caseload limits it to a review of a relatively small number of cases. See *England* v. *Louisiana State Board of Medical Examiners,* 375 U.S. 411, 416, 84 S.Ct. 461, 11 L.Ed.2d 440 (1964)."

Surely the time has come for this Court to perform its duty to create a uniform rationalized rule to control the question whether or when a state court adjudication, incidentally resolving a question of federal law contrary to federal interpretation of that law, should estop federal courts from determining issues of law that, by Congressional command, fall within their ambit.

II

Under the California Constitution the Prior Action of the California Court Is Not Entitled to Res Judicata Effect

The court below treated the denial of certiorari by the California court as a determination on the merits even though *no reasons* for the court's action were stated. Ignored was Article VI, Section 14 of the California Constitution, which provides:

> "Decisions of the Supreme Court and courts of appeal that determine causes shall be in writing with reasons stated."

The Court of Appeals relied upon *Napa Valley Electric Co.* v. *Railroad Commission,* 251 U.S. 366 (1920), where this Court held that the denial of a petition for a writ of certiorari by the California Court without opinion in an appeal from a decision of the Commission was on the merits and thus entitled to res judicata effect.

The briefs in *Napa* did not mention the California Constitutional provision and this Court did not consider it in its opinion. In fact the California decisions relied upon by this Court in *Napa* all had met the constitutional requirement of stating reasons for the denial of the writ.[4] The *Napa* decision, rendered before

[4] Cited at 251 U.S. at 372 are: *C. A. Hooper & Co.* v. *Railroad Commission,* 175 Cal. 811 (1917) *memorandum case* (denial of application for writ of review with statement of reason); *E. Clemens Horst Co.* v. *Railroad Commission,* 175 Cal. 660 (1917) (denial of application for certiorari with reasons given); *Mt. Konocti Light & Power Co.* v. *Thelen,* 170 Cal. 468 (1915) (denial of application for writ of certiorari with reasons given); *Ghriest* v. *Railroad Commission,* 170 Cal. 63 (1915) (denial of application for writ of certiorari to review an order of the California Railroad Commission with reasons given).

Erie Railroad Co. v. *Tompkins,* 304 U.S. 64 (1938), was understood to establish the state law and has been followed by the courts without discussion of the Constitutional provision.[5] In this fashion an unfortunate error crept into California jurisprudence: The protection of Article VI, Section 14 was denied appeals from the Public Utilities Commission, but is accorded litigants in all other appeals.[6]

The continuing validity of the *Napa* line of cases is undermined by recognition of the Constitutional protection of Article VI, Section 14 and by the views expressed in *People* v. *Medina,* 6 Cal.3d 484 (1972) where the constitutional requirement was argued. There the court pointed out that to allow conclusive effect to appellate orders that did not state reasons would "evade the state constitutional requirement of written opinions." *People* v. *Medina, supra,* 6 Cal.3d at 490.

The result of adhering to the *Napa* rule is a denial of the equal protection of the state constitutional provision. For the federal court to effectuate such a denial transgresses the protection of the due process clause of the Fifth Amendment.

[5] *Adams* v. *Decoto,* 21 F.2d 221 (S.D. Cal. 1927); *Consolidated Freightways, Inc.* v. *Railroad Commission,* 36 F.Supp. 269, 270-71 (N.D. Cal. 1941); *People* v. *Western Air Lines,* 42 Cal.2d 621 (1954), *appeal dismissed,* 348 U.S. 859 (1954).

[6] *E.g., People* v. *Medina,* 6 Cal.3d 484, 490 (1972); *Funeral Directors Ass'n* v. *Board of Funeral Directors,* 22 Cal.2d 104, 106 (1943); *People* v. *Carrington,* 40 Cal.App.3d 647, 650 (1974); *Traube Pittman Corp., Ltd.* v. *Board of Supervisors,* 49 Cal.App. 2d 463, 464 (1942); *People* v. *Credit Managers Ass'n,* 76 Cal.App. 3d 344, 347 n.3 (1977).

III

The Decision Below Conflicts With Equitable Doctrines Announced by This Court

The court below mistakenly viewed the Commission's decision as a static judgment. The continuing, prospective nature of the Decision is the same as a decree of equity. A court must modify a decree when the law has changed. *System Federation No. 91* v. *Wright,* 364 U.S. 642 (1961). The holding in *System Federation* should have equal application to the continuing regulatory order based upon an erroneous application of federal law. As phrased by this Court:

> ". . . the court cannot be required to disregard significant changes in law or facts if it is 'satisfied that what it has been doing has turned through changing circumstances into an instrument of wrong.' . . . A balance must thus be struck between the policies of res judicata and the right of the court to apply modified measures to changed circumstances." (364 U.S. at 647-648)

The same equitable principles, which are strongly embedded in American law,[7] apply to this action. In finding Petitioner "met the requirements for injunctive relief" the District Court recognized the clear probability[8] that the federal law was contrary to the

[7] *E.g.*, Fed. Rules Civ. Proc., rule 60(b)(5); Calif. Code of Civil Procedure § 473.

[8] This is confirmed by an examination of the Internal Revenue Code and Treasury Regulations and by the I.R.S. rulings which were issued after the Commission entered the Decision. Further confirmation is provided by the amicus brief of the Solicitor General filed with this Court in 78-606 and by the amicus brief of the United States filed June, 1979 with the Court of Appeals. The commentators have also viewed the Commission action as inconsistent with the federal law. Warren, *Tax Accounting In Regulated Industries: Limitations On Rate Base Exclusions,* 31 Rutgers L.Rev. 187; Note, 31 Stanford L.Rev. 265.

Commission's holding and that the Decision had become "an instrument of wrong". At that point the District Court should fashion a preliminary remedy such as that sought here under which effectuation of the Decision is suspended and the rates are collected subject to refund pending final resolution. This is not simply a matter of equity; due process requires relief as does proper recognition of the federal court's role in securing the objectives of Congress in enacting the tax subsidy.

Petitioner is exposed to an ever growing multiple liability. The state Commission requires it to pass a portion of the federal tax subsidy on to the ratepayers by lowering rates. But if too large a portion of the subsidy is so "flowed through"—as the I.R.S. contends—that action itself destroys eligibility and the entire tax benefit must be repaid the federal government. The regulatory Commission professes an inability to correct matters as to the past period once the Decision is placed in effect and refuses to modify its Decision prospectively although it clearly has the power. Calif. Pub.Util.Code § 1708. The closest precedent and one that should be controlling is *Western Union Telegraph Company* v. *Pennsylvania,* 368 U.S. 71 (1961). There the state obtained an escheat order with respect to unclaimed wire transfer funds. This Court held the state court action if permitted to be final denied Western Union due process for it could not bind other claimants, thus exposing the company to multiple liability.

Moreover, it was not the intent of Congress when it enacted the tax benefit program that the intended beneficiary of the program be injured rather than helped. A federal court of equity cannot sit idly by when it concludes an error as to federal law has converted the Congressional program into a vehicle of destruction. Respect for the actual Congressional objectives requires no less.

This suit does not seek an unwarranted federal review of the state administrative process. Both the state policy, as embodied in the Decision, and the federal policy, as enacted in the Code, is to preserve eligibility for the tax benefits.[9] The federal statutes limiting tax litigation with the United States make a resolution more difficult than in the ordinary situation and the complaint seeks a reasonable protective procedure to avoid massive injury. Protecting Petitioner while finally determining the correct construction of the Internal Revenue Code furthers both the state and federal policies.

[9] It would be another matter had California held it did not care about the federal tax benefits and had not sought to preserve them. In such case the matter would be purely one of state regulatory policy, so long as the rates were made with the recognition that the tax subsidy would not then exist.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that certiorari should be granted.

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Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

SUPPLEMENT TO PETITION

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PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ET AL.,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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SUPPLEMENT TO PETITION

Petitioner, The Pacific Telephone and Telegraph Company, respectfully submits that, since its Petition was filed herein on August 10, 1979, the following events have taken place:

On August 20, 1979, since the California Public Utilities Commission decision was no longer subject to restraint, petitioner filed a refund plan and rate reductions with the Commission. Several intervenors (Toward Utility Rate Normalization, the City and County of San Francisco, the City of Los Angeles and the City of San Diego, and the Independent Taxpayers Union of California) have filed responses and alternative suggestions concerning the refunds and rate reductions.

The refunds have not yet been made, and the rate reductions have not gone into effect. Meanwhile, petitioner's potential tax liability continues to grow at the rate of approximately $22 million per month.

On September 27, 1979, the Internal Revenue Service issued its notice of tax deficiency for the taxable year ended December 31, 1974. That notice included, *inter alia,* a deficiency of almost $89 million attributable to petitioner's ineligibility for accelerated depreciation and the investment tax credit under the Commission's Decision 87838 in September, 1977. The IRS indicated it was acting in accordance with its previous ruling that the Commission's decision is inconsistent with the Internal Revenue Code.

Respectfully submitted,

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GENERAL TELEPHONE COMPANY OF CALIFORNIA,
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THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ET AL.,
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JOINT APPENDIX FOR PETITIONERS

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 79-3150

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY,
Plaintiff/Appellant

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,
et al., Defendants/Appellees

CITY OF LOS ANGELES, CITY OF SAN DIEGO, CITY AND COUNTY OF SAN FRANCISCO, TOWARD UTILITY RATE NORMALIZATION,
Intervenors.

No. 79-3151

GENERAL TELEPHONE COMPANY OF CALIFORNIA,
A California corporation, *Plaintiff/Appellant*

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,
et al., Defendants/Appellees.

Appeal from the United States District Court
for the Central District of California

Before: CHOY and GOODWIN, Circuit Judges, and EAST,* District Judge.

CHOY, Circuit Judge:

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* The Honorable William G. East, Senior United States District Judge for the District of Oregon, sitting by designation.

Opinion

Pacific Telephone & Telegraph Co. (PTT) and General Telephone Co. of California (GT) appeal from the district court's denial of a preliminary injunction. We affirm.

I. Statement of the Case

On September 13, 1977, the Public Utilities Commission of California (PUC), which regulates certain charges of PTT and GT, entered its Decision No. 87838. It ordered the two companies, engaged in providing telephone service in California, to refund certain monies paid by ratepayers for years prior to 1978 and to make rate reductions for the year 1978 and beyond. In so deciding, the PUC stated explicitly that it assumed that its order would not destroy the utilities' eligibility to take advantage of certain federal tax rules pertaining to accelerated depreciation and investment tax credits.

The PUC refused appellants' request for a rehearing on Decision No. 87838. The PUC, however, stayed implementation of its order pending judicial review. Upon two petitions by the utilities, the California Supreme Court refused to disturb the PUC's order.[1] And the United States Supreme Court denied two writs of certiorari and later denied appellants' petitions for rehearing. On March 14, 1979, the PUC ended the stay of its order because "the avenues of judicial review have been exhausted" and also again denied appellants' petition for rehearing.

Meanwhile, the utilities sought rulings from the United States Internal Revenue Service (IRS) concerning their eligibility for accelerated depreciation and investment tax credits under Decision No. 87838. The IRS ruled that the utilities would not be eligible for the tax advantages under the PUC's Decision No. 87838.

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[1] The procedural aspects of the California Supreme Court's refusal to disturb the PUC's order are discussed in part II *infra*.

On March 15, 1979, a day after the PUC ended the stay of its order, the utilities began the instant litigation. PTT filed suit against the PUC and various federal officials related to the IRS[2] seeking to enjoin implementation of the PUC's rate order and seeking a declaratory judgment regarding PTT's eligibility for the tax advantages under the PUC's order. PTT also requested that if the court determined that PTT would be ineligible, then the PUC should be enjoined permanently from putting its order into effect. On the same day, GT instituted a similar suit.

PTT and GT each sought a temporary restraining order (TRO) and a preliminary injunction against implementation of the PUC's order. The cities of Los Angeles and San Diego, the City and County of San Francisco, and an organization called Toward Utility Rate Normalization were allowed to intervene. The PUC and these intervenors[3] opposed the motions for injunctive relief. The federal Government filed a motion to dismiss the action insofar as declaratory relief was sought.[4]

The district court granted a TRO staying implementation of the PUC order. Two weeks later the district court dissolved the TRO[5] and denied appellants' prayers for pre-

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[2] The federal officials were the Secretary of the Treasury and the Commissioner of Internal Revenue.

[3] The United States has filed a brief in this court as amicus curiae discussing the Government's analysis of the tax questions relating to the utilities' eligibility for accelerated depreciation and investment tax credits under the PUC's order. *See* note 4 *infra*.

[4] The present appeal involves interlocutory review of a district court order regarding an injunction under 28 U.S.C. § 1292(a)(1). We do not discuss the utilities' request for declaratory relief, nor do we intimate any view on the proper interpretation of the federal tax statutes regarding accelerated depreciation and investment tax credits. *See* note 3 *supra*.

[5] The district court issued the TRO on March 15, 1979. Because of the ten-day time limit on TRO's imposed by Fed.R.Civ.P. 65(b), on March 20, 1979, the parties stipulated to the extension of the

liminary injunctions. On the same day, PTT and GT filed appeals in this court. A few days later this court enjoined implementation of the PUC order pending this appeal.

II. Application of Res Judicata

The district court determined that appellants were not entitled to preliminary relief because

> The relief requested by plaintiffs herein is barred under the doctrine of res judicata by the denial by the California Supreme Court without written opinion of petitions for writ of review of Decision No. 87838 filed by General and Pacific.

The district court properly applied the doctrine of res judicata.

A. Application of Res Judicata in California Rate Cases: The Napa Valley Decision

The United States Supreme Court and this court have acknowledged that, under California law, the California Supreme Court's denial of writs of review of rate decisions constitute a denial on the merits and have held that such denials are entitled to res judicata effect in federal courts. In *Napa Valley Electric Co.* v. *Railroad Commission,* 251 U.S. 366 (1920), a California electric company filed suit in federal district court seeking an injunction against a rate order of the California Railroad Commission, a forerunner of the present PUC. After the Commission had issued its rate order, the utility unsuccessfully sought a rehearing. The California Supreme Court later denied the utilities' petition for a writ of review. The federal suit was thereupon filed.

TRO until March 30, 1979. The district court issued its order dissolving the TRO and denying the preliminary injunctions on March 30, 1979.

The district court denied the injunction and dismissed the federal suit because "the Electric Company filed in the [California] Supreme Court a petition for a review of the decision and order of the Commission and for their annulment, and . . . the Supreme Court denied the petition." *Id.* at 370.

The United States Supreme Court held that the district court had properly invoked the doctrine of res judicata. *See id.* at 367. The Court wrote:

> Whether . . . the [California] court was required to pursue the details of the section or decide upon the petition was a matter of the construction of the [California statutory] section and the procedure under it. And the [California] Supreme Court has so decided. [Citations omitted.] In those cases the applications for writs of certiorari were denied, which was tantamount to a decision of the [California] court that the orders and decisions of the Commission did not exceed its authority or violate any right of the several petitioners under the Constitution of the United States or of the State of California. . . . And we agree with the District Court that "the denial of the petition was necessarily a final judicial determination . . . ." And . . . "Such a determination is as effectual as an estoppel as would have been a formal judgment upon issues of fact." [Citations omitted.]
>
> The [district] court held, and we concur, that absence of an opinion by the [California] Supreme Court did not affect the quality of its decision or detract from its efficacy as a judgment upon the questions presented, and *its subsequent conclusive effect upon the rights of the Electric Company.*

Id. at 372-73 (emphasis added).[6] This Circuit has subse-

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[6] The Supreme Court's language in *Napa Valley* indicates that the California Supreme Court's denial of review should be given

quently embraced the *Napa Valley* doctrine. *See Southern Pacific Co.* v. *Van Hoosear*, 72 F.2d 903, 905 (9th Cir. 1934); *Wallace Ranch Water Co.* v. *Railroad Commission*, 47 F.2d 8, 9 (9th Cir. 1931).

B. Continued Vitality of Napa Valley

The procedure for obtaining review of rate orders with which the Supreme Court dealt in *Napa Valley* has since been slightly modified and recodified, but the essential attributes of the procedure upon which the Supreme Court re-

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res judicata effect even as to questions of federal constitutional law. Appellants suggest that the federal courts are now more reluctant to apply res judicata based on state court decisions when questions of construction of federal statutory or constitutional provisions exist.

We note that subsequent to *Napa Valley*, the California legislature modified the law regarding judicial review of rate orders to broaden and enhance the California Supreme Court's ability to inquire into federal constitutional questions in rate review, Cal. Pub.Util. Code § 1760 *quoted at* note 7 *infra; see* Pac. Tel. & Tel. Co. v. Pub. Util. Comm'n, 62 Cal. 2d 634, 646, 401 P.2d 353, 360, 44 Cal. Rptr. 1, 8 (1965). This militates in favor of the *Napa Valley* approach.

We need not determine, however, if later cases have eroded federal deference to state interpretations of federal questions. In the instant case appellants' constitutional claims are frivolous. *See* note 15 *infra*. And the federal courts have not been asked in this proceeding for injunctive relief to interpret a federal statute. Appellants went to state court to have it overturn a state agency's rate order. Now they ask the federal courts to overturn the order. While appellants' underlying disagreement with the rate order is that the PUC allegedly misunderstood federal tax law (assuming that the IRS's interpretation is correct), whether this misunderstanding vitiates the rate order does not involve construction of a federal statute, but rather depends upon the scope of the PUC's discretion in setting rates. *Cf.* Napa Valley Electric Co. v. R.R. Comm'n, 251 U.S. 366, 372 (1920).

lied have remained the same.[7] Thus, in *People* v. *Western*

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[7] At the time of *Napa Valley*, the provision for judicial review of rate orders read:

> Within thirty days after the application for a rehearing is denied, or, if the application is granted, then within thirty days after the rendition of the decision on rehearing, the applicant may apply to the supreme court of this state for a writ of certiorari or review (hereinafter referred to as a writ of review) for the purpose of having the lawfulness of the original order or decision or the order or decision on rehearing inquired into and determined. Such writ shall be made returnable not later than thirty days after the date of the issuance thereof, and shall direct the commission to certify its record in the case to the court. On the return day, the cause shall be heard by the supreme court, unless for a good reason shown the same be continued. No new or additional evidence may be introduced in the supreme court, but the cause shall be heard on the record of the commission as certified to by it. The review shall not be extended further than to determine whether the commission has regularly pursued its authority, including a determination of whether the order or decision under review violates any right of the petitioner under the constitution of the United States or of the State of California. The findings and conclusions of the commission on questions of fact shall be final and shall not be subject to review; such questions of fact shall include ultimate facts and the findings and conclusions of the commission on reasonableness and discrimination. The commission and each party to the action or proceeding before the commission shall have the right to appear in the review proceeding. Upon the hearing the supreme court shall enter judgment either affirming or setting aside the order or decision of the commission. The provisions of the Code of Civil Procedure of this state relating to writs of review shall, so far as applicable and not in conflict with the provisions of this act, apply to proceedings instituted in the supreme court under the provisions of this section. No court of this state (except the supreme court to the extent herein specified) shall have jurisdiction to review, reverse, correct or annul any order or decision of the commission or to suspend or delay the execution or operation thereof, or to enjoin, restrain or interfere with the commission in the performance of its official duties; *provided*, that the writ of man-

damus shall lie from the supreme court to the commission in all proper cases.

1915 Cal.Stats. ch. 91, pp. 161-62, § 67. Presently, Cal.Pub.Util. Code §§ 1756-1760, first enacted in 1951, apply. Section 1756 now provides:

> Within 30 days after the application for a rehearing is denied, or, if the application is granted, then within 30 days after the decision on rehearing, the applicant may apply to the Supreme Court of this State for a writ of certiorari or review for the purpose of having the lawfulness of the original order or decision or of the order or decision on rehearing inquired into and determined. The writ shall be made returnable at a time and place then or thereafter specified by court order and shall direct the commission to certify its record in the case to the court within the time therein specified.

Section 1757 reads:

> No new or additional evidence may be introduced in the Supreme Court, but the cause shall be heard on the record of the commission as certified to by it. The review shall not be extended further than to determine whether the commission has regularly pursued its authority, including a determination of whether the order or decision under review violates any right of the petitioner under the constitution of the United States or of this State.
>
> The findings and conclusions of the commission on questions of fact shall be final and shall not be subject to review except as provided in this article. Such questions of fact shall include ultimate facts and the findings and conclusions of the commission on reasonableness and discrimination.

Section 1758 provides:

> The commission and each party to the action or proceeding before the commission may appear in the review proceeding. Upon the hearing the Supreme Court shall enter judgment either affirming or setting aside the order or decision of the commission. The provisions of the Code of Civil Procedure relating to writs of review shall, so far as applicable and not in conflict with the provisions of this part, apply to proceedings instituted in the Supreme Court under provisions of this article.

Section 1759 reads:

> No court of this State, except the Supreme Court to the extent specified in this article, shall have jurisdiction to review, reverse, correct, or annul any order or decision of the commission or to suspend or delay the execution or operation thereof, or to enjoin, restrain, or interfere with the commission in the performance of its official duties, except that the writ of mandamus shall lie from the Supreme Court to the commission in all proper cases.

Air Lines, 42 Cal.2d 621, 268 P.2d 723 (1954),[8] *appeal dismissed*, 348 U.S. 859 (1955),[9] the California Supreme Court reaffirmed the rule relied upon in *Napa Valley* that denial

Section 1760 provides:

> In any proceeding wherein the validity of any order or decision is challenged on the ground that it violates any right of petitioner under the Constitution of the United States, the Supreme Court shall exercise an independent judgment on the law and the facts, and the findings or conclusions of the commission material to the determination of the constitutional question shall not be final.

For a discussion of the purpose underlying § 1760, *see* note 6 *supra*.

[8] Between the date of *Western Air Lines* and the present, there has been only one minor modification of the procedure for judicial review of rate orders. The final sentence of § 1756 as quoted in note 7 *supra* was added in 1963. 1963 Cal.Stats. ch. 461, p. 1310, § 6. Prior to that time, § 1756 ended:

> The writ shall be made returnable not later than 30 days after the date of issuance, and shall direct the commission to certify its record in the case to the court. On the return day, the cause shall be heard by the Supreme Court, unless for a good reason shown it is continued.

This administrative change gives the California Supreme Court greater flexibility in timing returns, records, and hearings. It does not affect the essential procedures for obtaining review of rate orders which underlay *Napa Valley* and *Western Air Lines*.

[9] The United States Supreme Court wrote in a per curiam:

> The motion to dismiss is granted and the appeal is dismissed for the want of a substantial federal question.

348 U.S. at 859. *See* note 6 *supra*.

of a writ of review is a final judgment on the merits; it also applied that rule specifically to the PUC. The California court wrote:

> Direct attack [on PUC orders] is made available by application for a writ of review to this court . . . .
>
> . . . It is established . . . that the denial by this court of a petition for review of an order of the commission is a decision on the merits both as to the law and the facts presented in the review proceedings. [Citation omitted.] This is so even though the order of this court is without opinion. Napa Valley Electric Co. . . . .

Id. at 630-31, 268 P.2d at 728. The court then quoted extensively from *Napa Valley,* including its language regarding application of res judicata to denials of writs of review by the California court. *Id.* We conclude, therefore, that the recodification of California law has not affected the vitality of the *Napa Valley* reading of California procedure or of the *Napa Valley* decision itself.

C. Effect of People v. Medina

Appellants contend that *People* v. *Medina,* 6 Cal.3d 484, 492 P.2d 686, 99 Cal. Rptr. 630 (1972), has undermined the rule that the California Supreme Court's denial of a writ of review of a PUC order constitutes a final adjudication for res judicata purposes. We disagree.

Medina was charged in a criminal prosecution with unlawfully possessing heroin for sale. At a pretrial hearing he moved to suppress evidence because of an alleged unlawful search. The trial court denied the motion. Medina filed a formally sufficient petition for a writ of prohibition to gain review of the trial court's evidentiary ruling as provided by California Penal Code § 1538.5.[10] The Court of Ap-

[10] The *Medina* court wrote:

> Section 1538.5 provides that the defendant may seek pretrial appellate court review of the superior court's order denying his motion to suppress evidence by petitioning for a writ of mandate or prohibition and that he "may seek further review of the validity of a search or seizure on appeal from a conviction."

6 Cal. 3d at 488, 492 P.2d at 688, 99 Cal. Rptr. at 632 (footnote omitted).

peal denied the petition without opinion and the California Supreme Court denied a hearing.

After conviction Medina appealed, again claiming that the evidence should have been suppressed. The Court of Appeal held that the denial of the writ of prohibition was res judicata upon this direct appeal, creating a conflict with another Court of Appeal decision which held "that the denial without opinion of a defendant's pretrial petition for a writ under section 1538.5 is not a conclusive determination of the validity of the challenged search." *Id.* at 488, 492 P.2d at 688, 99 Cal.Rptr. at 632. The California Supreme Court held that the latter view of a denial of a § 1538.5 writ was correct. *Id.* at 488, 492 P.2d at 688, 99 Cal. Rptr. at 632.

The California Supreme Court first noted that the legislative history of Penal Code § 1538.5 showed that the state legislature intended "that the merits of search and seizure challenges raised by a defendant's unsuccessful petition for a pretrial writ may remain open for further review on appeal from an ensuing judgment of conviction." *Id.* at 489, 492 P.2d at 689, 99 Cal. Rptr. at 633. The court also observed that the legislature in enacting "new procedures for the presentation of search and seizure challenges" did not intend to alter the traditional California procedure affording a criminal defendant a written opinion and formal hearing as to his fourth amendment contentions. *Id.* at 490, 492 P.2d at 689, 99 Cal. Rptr. at 633. Yet, the court wrote, if the denial of a writ, which does not require a hearing or written opinion under the California constitution or procedure, were given res judicata effect, then the criminal defendant

would lose those benefits traditionally afforded. Moreover, defense counsel, recognizing this problem, would cease to invoke § 1538.5, thus undermining the legislature's intent to provide this method of challenging admissibility of evidence. *Id.* at 490, 492 P.2d at 689-90, 99 Cal. Rptr. at 633-34.

The court rejected the People's argument that res judicata should be applied anyway because "the sole possible ground of the . . . denial of defendant's petition . . . was on the merits . . . ." *Id.* at 490, 492 P.2d at 690, 99 Cal. Rptr. at 634. The court wrote:

> [W]e cannot accept the People's contention that the sole possible ground for denying defendant's petition for the writ was a determination against him on the merits. We have continued to recognize that the writs of mandate and prohibition are "extraordinary" and "prerogative" and that therefore their use for pretrial review . . . should be confined to questions of . . . general importance.

Id. at 491, 402 P.2d at 690, 99 Cal. Rptr. at 634. The court then referred to the many reasons, not related to the merits, because of which the Court of Appeal may have denied the writ. The court concluded:

> In light of the various considerations which may impel appellate justices to vote to deny a defendant's petition for a pretrial writ under section 1538.5 without opinion, we believe that giving such a minute order conclusive effect on an appeal from a subsequent judgment of conviction would amount to improper conjecture and surmise as to the theoretically possible mental processes of the justices.

Id. at 492, 492 P.2d at 691, 99 Cal. Rptr. at 635. The court added:

> In view of the express language of section 1538.5, application of the doctrine of res judicata to give conclusive effect on appeal from a judgment of conviction to an appellate court's earlier decision denying defendant's application for a pretrial writ would be inappropriate even when the denial of the writ is by an opinion demonstrating adjudication of the merits. The statute permits the defendant to seek further review of the validity of the challenged search on appeal from a judgment of conviction . . . .

Id. at 492, 492 P.2d at 691, 99 Cal. Rptr. at 635.

The foregoing indicates that *Medina* did not affect the long-time California rule, reaffirmed in *Western Air Lines*, that the Supreme Court's denial of a writ of review of a rate order is a decision on the merits for res judicata purposes. *Medina* dealt with the res judicata effect of the denial of an extraordinary writ provided by the legislature under Penal Code § 1538.5 to afford a criminal defendant two opportunities to obtain review of trial court rulings on fourth amendment questions. The California Supreme Court concluded that application of res judicata, whether denial of a writ under § 1538.5 is with or without opinion, would be inconsistent with the legislature's intent in providing two opportunities for review.[11]

Thus, *Medina* did not deal with the non-criminal writ of review provided by Public Utilities Code § 1756 as the sole means of obtaining judicial review of PUC rate orders.[12] *Medina* did not purport to overrule or limit *Western Air Lines* or the traditional rule applied in *Napa Valley*. Indeed, the *Medina* court did not even cite *Western Air Lines*, though one would expect such a citation were *Medina* intended to overrule the long-followed practice reaffirmed in that decision.

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[11] *See* the preceding quotation in text.

[12] *See* note 7 *supra*.

Appellants argue that *Medina* found the constitutional requirement of a written opinion to be an obstacle to application of res judicata when a writ is denied without written opinion. This is incorrect. First, while the particular case before the court involved a denial without written opinion, the court indicated that whether or not an opinion had been issued in denying a § 1538.5 writ, giving res judicata effect to the denial would conflict with the legislature's intent to provide duplicitous review.[13] Second, the court noted that the California constitutional provision requiring written opinions in some cases did not apply to the denial of writs. *Id.* at 490, 492 P.2d at 689, 99 Cal. Rptr. at 633. Indeed, the court wrote:

> The denial without opinion of a petition for a writ of mandate or prohibition is not res judicata except when the sole possible ground of denial was on the merits or it affirmatively appears that the denial was intended to be on the merits.

Id. at 491 n.6, 492 P.2d at 690 n.6, 99 Cal. Rptr. at 634 n.6. Thus, although the court also noted that the multitude of reasons why a writ under Penal Code § 1538.5 might be denied made it difficult to read the denial (at least in the case before it) as on the merits, it indicated that even in the context of writs of prohibition and mandate the absence of a written opinion was not necessarily fatal to application of res judicata.[14]

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[13] 6 Cal.3d at 492, 492 P.2d at 691, 99 Cal. Rptr. at 635. *See* discussion *supra*.

[14] As noted *supra*, we do not believe that *Medina*, dealing with a particular type of writ of prohibition or mandate in the criminal context, can reasonably be read as impinging upon the much different context of the writ of review provided by Cal.Pub.Util. Code §§ 1756-1760. However, even if we assume that *Medina* states the standard for application of res judicata to writs of review of PUC orders, res judicata was properly applied here. While Cal. Pen. Code § 1538.5 provides for duplicitous appellate review which may be denied without resort to the merits, Cal. Pub. Util. Code §§ 1756-1760 provide the exclusive means of obtaining appellate review of a PUC order. Thus, a denial of a writ of review must be interpreted as having involved rejection on the merits of appellants' claims.

In short, we conclude that *Medina* did not undermine the long-followed California rule that the Supreme Court's denial of a writ of review of a rate order without opinion constitutes a final judgment entitled to res judicata effect. Therefore, *Napa Valley*, involving a situation almost identical to the case before us, mandates application of res judicata in the present case.[15] Accordingly, the district court's invocation of res judicata and its judgment are

AFFIRMED.

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[15] Appellants contend that it is both unfair and violative of due process to invoke res judicata here, allegedly because they have not had their day in court. We disagree. Appellants have presented their claims to the PUC on three occasions. They have also presented their claims to the California Supreme Court and sought a writ of certiorari from the United States Supreme Court as well as a rehearing on the Supreme Court's denial of certiorari. Moreover, appellants will have an opportunity to present to the federal courts their contentions regarding the proper interpretation of federal tax statutes if and when the IRS seeks to collect the contested taxes. Additionally, appellants may also have an opportunity to litigate those interpretations in their declaratory relief action, though we express no opinion as to the propriety or proper outcome of that matter. *See* note 4 *supra*. That appellants' litigation efforts have been unsuccessful does not warrant rejection of res judicata; that doctrine is generally applied only because one side to litigation has lost and one side has won.

APPENDIX B

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

No. 79 1024 RMT (GX)

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY,
Plaintiff,

vs.

THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ET AL.
Defendants.

No. 79 1025 RMT (GX)

GENERAL TELEPHONE COMPANY OF CALIFORNIA,
Plaintiff,

vs.

THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ET AL.
Defendants.

Findings of Fact and Conclusions of Law Re Denial of Motion for Preliminary Injunction

Motions in each of the above-entitled actions for preliminary injunction came on regularly for hearing in the above-entitled Court on March 30, 1979 at 9:50 A.M., the plaintiff, defendants and intervenors being then and there represented by their respective counsel of record. Whereupon, all parties were given an opportunity to be heard and the matter was argued and submitted for decision.

NOW, THEREFORE, the Court having read the papers filed by the parties and having heard the arguments of counsel and being fully advised in the premises, enters the following findings of fact and conclusions of law.

Findings of Fact

1. Plaintiffs Pacific Telephone Company ("Pacific") and General Telephone Company of California ("General") are each engaged in rendering public utilities service in the State of California in the business of supplying exchange and toll telephone service within some areas of the State of California, as well as telephone service between telephone stations in the State of California and stations in other states of the United States and in foreign countries.

2. Defendant Public Utilities Commission of the State of California ("Commission") is a political subdivision of the State of California created and existing under Article XII of the Constitution of the State of California. The Commission is empowered to administer the provisions of the California Public Utilities Code.

3. Defendants John E. Bryson, Claire T. Dedrick, Richard D. Gravelle, Vernon L. Sturgeon and Leonard M. Grimes are the present individual members of the Commission.

4. The tolls, charges, rates and other practices of plaintiffs for intrastate telephone service within the State of California are subject to regulation by the Commission under the Public Utilities Code.

5. The individual defendants who are the present members of the Commission in their official capacities reside in this district.

6. On September 13, 1977 the Commission entered Decision No. 87838, which decision ordered Pacific and General each to make certain refunds to its rate payers for years prior to 1978 and to implement rate reductions in 1978 and subsequent years. The refunds so ordered total approximately $65,440,000.00 for General and $205,586,000.00 for Pacific. The amount of the rate reductions so ordered total approximately $13,000,000.00 in 1978 for General and $93,000,000.00 in 1978 for Pacific.

7. Decision No. 87838 is predicated upon the finding that the making of said refunds and rate reductions will not impair the eligibility of General or Pacific to utilize accelerated depreciation in their Federal Income Tax Returns and to receive investment tax credits pursuant to Sections 167(l) and 46(f) of the Internal Revenue Code.

8. If the eligibility of General and Pacific to utilize accelerated depreciation and to receive investment tax credits as aforesaid is destroyed by Decision No. 87838, General will incur a tax liability of approximately $211,084,000.00, plus $32,000,000.00 in accrued interest for the years 1970 through 1977 and will incur increasing tax liability in subsequent years. In such event Pacific may incur a tax liability for the years 1974 through 1978 in excess of $1 billion and will incur an increasing liability in subsequent years.

9. If the making of the ordered refunds and rate reductions is found to destroy the eligibility of Pacific and General for accelerated depreciation and investment tax credits it will not be possible after a determination to that affect to recoup such refunds and rate reductions so as to restore such eligibility.

10. The Internal Revenue Service by private ruling has declared that the implementation of the ordered refunds and rate reductions will destroy the eligibility of Pacific and General for accelerated depreciation and investment tax credits for Federal Income Tax purposes.

11. On June 13, 1978 the California Supreme Court denied without written opinion petitions for a writ of review of Decision No. 87838 and on December 11, 1978 the United States Supreme Court denied petitions for writ of certiorari.

12. By virtue of petitions and orders timely made in proceedings before the Commission, Decision No. 87838 was suspended until March 13, 1979 and by temporary restraining order issued by this Court on March 15, 1979 and by

minute order herein dated March 26, 1979 said Decision was further suspended until March 30, 1979.

13. Pacific and General would each suffer irreparable injury if their compliance with Decision No. 87838 were to cause them to lose their eligibility for accelerated depreciation and investment tax credits on their Federal Income Tax Returns.

Conclusions of Law

1. This Court has jurisdiction of the subject matter of this action pursuant to Title 28 U.S.C. § 1331, in that this is a civil action wherein the matter in controversy exceeds the sum or value of $10,000.00, exclusive of interest and costs, and arises under the statutes of the United States.

2. There is a case or controversy between the parties to this action in that Pacific and General have been ordered by the Commission to make the refunds and rate reductions referred therein, compliance with which order threatens their respective eligibility for accelerated depreciation and investment tax credit under Sections 167(l) and 46(f) of the Internal Revenue Code.

3. The limitations on the jurisdiction of this Court under the Johnson Act (28 U.S.C. § 1342) do not apply in this case in that jurisdiction is not based solely on diversity of citizenship or repugnance of Decision No. 87838 to the Federal Constitution.

4. The relief requested by plaintiffs herein is barred under the doctrine of res judicata by the denial by the California Supreme Court without written opinion of petitions for writ of review of Decision No. 87838 filed by General and Pacific.

5. General and Pacific have each met the requirements for the issuance of injunctive relief.

DATED: March 30, 1979.

/s/ ROBERT M. TAKASUGI
Robert M. Takasugi
District Judge

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

No. 79-1024-RMT

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY,
Plaintiff,

vs.

THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ET AL.
Defendants.

No. 79-1025-RMT

GENERAL TELEPHONE COMPANY OF CALIFORNIA,
Plaintiff,

vs.

THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ET AL.
Defendants.

Order

Based on the concurrently filed memorandum, IT IS HEREBY ORDERED, ADJUDGED AND DECREED that:

1. The Temporary Restraining Order imposed against defendant, Public Utilities Commission, is hereby dissolved; and

2. Plaintiffs' motion for a Preliminary Injunction is denied.

DATED: March 30, 1979.

/s/ ROBERT M. TAKASUGI
Robert M. Takasugi
United States District Judge

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

79-1024

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY,
a California corporation,
Plaintiff,

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA; CLAIRE T. DEDRICK, RICHARD D. GRAVELLE, VERNON STURGEON, LEONARD GRIMES, JR., and JOHN BRYSON, in their capacities as members of the Public Utilities Commission; W. MICHAEL BLUMENTHAL, Secretary of the Treasury, an agency of the United States of America; and JEROME KURTZ, Commissioner, Internal Revenue Service, an agency of the United States of America,
Defendants.

Complaint to Enjoin Violation of Federal Statutes and the Constitution of the United States of America; and in the Alternative, for Declaratory Relief

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY ("Pacific") alleges for its complaint, as follows:

Parties and Jurisdiction

1. Pacific is a corporation duly organized and existing under the laws of the State of California and authorized to

do business in the State of California, and doing business within the Central District of California.

2. Defendant PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA (the "Commission") is a political subdivision of the State of California, created and existing under Article 12 of the Constitution of the State of California. The Commission is empowered to administer the provisions of the California Public Utilities Code (the "Code"). Defendants CLAIRE T. DEDRICK, RICHARD D. GRAVELLE, VERNON STURGEON, LEONARD GRIMES, JR., and JOHN BRYSON are the present individual members of the Commission. Defendant Commission and defendants Dedrick, Gravelle, Sturgeon, Grimes and Bryson are sometimes referred to collectively herein as the "PUC Defendants".

3. Defendant W. MICHAEL BLUMENTHAL is Secretary of the Treasury and principal administrator of the Department of Treasury, an agency of the United States of America. Defendant JEROME KURTZ is Commissioner of the Internal Revenue Service (the "IRS"), an agency of the United States of America. Defendants Blumenthal and Kurtz are sometimes referred to collectively herein as the "IRS Defendants".

4. Pacific is lawfully engaged in rendering a public utility service in the State of California, subject to the provisions of the Code. It is engaged in the business of supplying exchange and toll telephone service within certain areas of the State of California, as well as telephone service between telephone stations in the State of California and stations in other states of the United States and in foreign countries. The tolls, charges, rates, and other practices of Pacific for intrastate telephone service within the State of California are subject to regulation by the Commission under the Code. The tolls, charges, rates, and other practices of Pacific for interstate telephone service are subject to regulation by the Federal Communications Commission.

5. This Court has jurisdiction of the subject matter of this complaint pursuant to Title 28 U.S.C. § 1331 in that this is a civil action wherein the matter in controversy exceeds the sum or value of ten thousand dollars ($10,000), exclusive of interest and costs, and arises under the statutes and Constitution of the United States; pursuant to Title 28 U.S.C. § 1340 in that this is a civil action arising under an Act of Congress providing for internal revenue; and pursuant to the Declaratory Judgment Act, 28 U.S.C. § 2201. Plaintiff does not have a plain, speedy and efficient remedy in the courts of the State of California for reasons hereinafter set forth.

6. Venue is properly laid in this District pursuant to Title 28 U.S.C. § 1391(b) in that the PUC Defendants, and each of them, in their official capacities, reside in this District; and pursuant to Title 28 U.S.C. § 1391(e) in that the IRS Defendants, and each of them, in their official capacities, are officers of agencies of the United States; and pursuant to Title 28 U.S.C. § 1391(b) and Title 28 U.S.C. § 1391 (e) in that the claim which is the subject of this complaint arose in this District.

Count I

Against the PUC Defendants to Enjoin the Violation of Federal Statutes and The Constitution of the United States of America.

7. On September 13, 1977, the Commission entered Decision No. 87838 (the "Decision"), which Decision orders Pacific to refund the sum of $205,586,000 (computed through January 1, 1978) to its ratepayers and to implement rate reductions currently aggregating approximately $148,000,000 per annum. The Decision is based upon express assumptions by the PUC Defendants which said assumptions apply erroneous methods of accounting for accelerated depreciation and the investment tax credit. These methods are denominated by the Commission as "Averaged Annual Adjustment", as to accelerated depreciation, and "Annual

Adjustment" as to the investment tax credit. A true and correct copy of the Decision is attached hereto as Exhibit "A".

8. On July 13, 1978, the California Supreme Court denied without a written opinion Pacific's petition seeking a writ of review of the Decision.

9. On December 11, 1978, the United States Supreme Court denied Pacific's petition for a writ of certiorari seeking review of the Decision, and on February 21, 1979 said Court denied Pacific's petition for rehearing thereon.

10. In January, 1979, the Commission ordered that its suspension of the Decision be terminated and that the Decision go into effect at such time as the Supreme Court of the United States denied Pacific's petition for rehearing. (A true and correct copy of the Commission's Order Terminating Suspension of Decision No. 87838 is attached hereto as Exhibit "B"). On March 14, 1979, the Commission denied Pacific's petition seeking rehearing of the Commission's order terminating the suspension. Accordingly, the Decision will be implemented unless this Court intervenes.

11. The Decision is expressly predicated upon the Commission's erroneous premise that the Averaged Annual Adjustment and Average Adjustment methods which the Decision utilizes in making Pacific's rates are consistent with the requirements of the Internal Revenue Code relating to Pacific's eligibility for accelerated depreciation (IRC § 167(l)) and the investment tax credit (IRC § 46(f)). Although the Decision purports to comply with the requirements of the Internal Revenue Code, the Decision is not binding upon the United States or the IRS. To the contrary, the Decision, if it is implemented, will render Pacific prospectively and retroactively ineligible for both accelerated depreciation and the investment tax credit, and the IRS has so notified Pacific in rulings issued on June 8, 1978 and July 27, 1978. True and correct copies of such rulings are attached hereto as Exhibits "C" and "D".

12. If the Decision is permitted to go into effect prior to a definitive resolution of the tax issues upon which the PUC Defendants based their Decision, and if the view of the PUC Defendants as to the meaning of the Internal Revenue Code is determined to be incorrect, Pacific will be grossly and irreparably injured, in that, among other things, by the time of such determination:

a. Pacific will have refunded to its ratepayers the $205,586,000 (computed through January 1, 1978) required by the Decision;

b. Pacific will have implemented rate reductions currently aggregating approximately $148,000,000 per annum (of which approximately $55,000,000 reflects the direct impact of Averaged Annual Adjustment and Annual Adjustment methods and the balance reflects rate reductions which would otherwise be proper assuming Pacific is eligible for accelerated depreciation and the investment credit, which tax benefits will be disallowed by the IRS if such methods are implemented); and

c. Pacific will be liable to the United States for enormous back taxes and interest as a result of deductions and credits previously taken by Pacific which were premised upon Pacific's eligibility for accelerated depreciation and the investment credit. Pacific's potential tax liability for completed years alone (*i.e.*, 1974 through 1978) would exceed one billion (1,000,000,000) dollars if the Commission's view of the Internal Revenue Code is determined to be erroneous, and could exceed three billion (3,000,000,000) dollars if a definitive determination were not made for several years, as is demonstrated by the table attached hereto as Exhibit "E". As a result of the implementation of the Decision, Pacific will be required to pass on to its ratepayers tax savings which it does not in fact enjoy.

The foregoing consequences of the Decision will be to reduce Pacific's rate of return for the years affected thereby to confiscatorially low levels.

13. If the injunction requested herein is denied and the refunds and rate reductions mandated by the Decision are implemented, and the Commission's interpretation of the Internal Revenue Code is determined to be erroneous, the consequences set forth in Paragraph 12 above will be beyond remedy by the Commission, or any other regulatory body or any court, in that there is no form of remedial ratemaking which could retroactively restore to Pacific its lost eligibility for accelerated depreciation and investment tax credit for the years covered by the Decision.

14. The enormous and irreparable loss to Pacific caused by the Decision will, inevitably, have a gross, devastating and irreparable impact upon the quality of interstate and intrastate telephone service in California and may pose dire consequences for the economy of the State.

15. If the Decision is permitted to be implemented prior to a determination of the tax questions in a manner binding upon the IRS, and if, as the IRS has indicated, Pacific is found to be retroactively ineligible for accelerated depreciation and the investment credit:

a. Pacific will be deprived by the PUC Defendants of its property without a proper purpose and without just compensation in violation of the Fifth and Fourteen Amendments of the United States Constitution, in that the PUC Defendants will have required refunds to be paid and rates to be reduced based upon an erroneous interpretation of the Internal Revenue Code; and

b. Pacific will be denied the right to meaningful judicial review of or remedy with respect to the relevant provisions of the Internal Revenue Code, and the interrelationship of such provisions to the propriety of

the Decision. If the interpretation of the Internal Revenue Code espoused by the PUC Defendants and upon which the Decision is premised is erroneous, Pacific cannot obtain meaningful relief from the consequences of the error of the PUC Defendants in violation of Pacific's rights under the Fifth and Fourteenth Amendments of the United States Constitution.

To permit the Decision to go into effect in advance of a definitive determination of the tax issues exposes Pacific to the above deprivations of its rights under the statutes and Constitution of the United States.

16. As a result of the foregoing, Pacific respectfully prays that this Court enter an order restraining and enjoining the PUC Defendants, and each of them, from enforcing, executing or making effective the Decision, until such time as Pacific's eligibility for accelerated depreciation and the investment tax credit under the Decision is definitively determined in a manner binding upon the IRS. The failure by this Court to stay the Decision will cause Pacific irreparable injury and leave Pacific without any plain and speedy and efficient remedy in the courts of the State of California; Pacific has no other adequate remedy at law. The Decision is repugnant to sections 167(l) and 46(f) of Title 28 of the United States Code, and to the Taking, Due Process and Supremacy Clauses of the United States Constitution and it will, moreover, impose an undue and unlawful burden on interstate commerce.

17. If an injunction is issued by this Court prohibiting the effectiveness of the Decision, timely procedures under the Internal Revenue Code will be invoked so that Pacific's entitlement to after such determination, as appropriate, in order to preserve Pacific's eligibility in the public interest.

Count II

Against All Defendants for Declaratory Relief

18. Pacific alleges and incorporates by reference Paragraphs 1 through 17 of Count I of this Complaint as if set forth in full herein.

19. In the event the Court is not disposed to grant the relief against the PUC Defendants requested in Count I, Pacific will for the reasons enumerated therein be deprived of all meaningful access to judicial review as to the consistency of the Decision and the Internal Revenue Code, in that in the event the position articulated by the IRS in its rulings of June 8, 1978 and July 27, 1978 is determined to be correct, Pacific will have been irreparably injured and without effective recourse to judicial review, in violation of Pacific's rights to due process as guaranteed by the United States Constitution. Accordingly, in the event this Court is not disposed to grant the relief against the PUC Defendants as requested in Count I, it is imperative that this Court issue its declaratory judgment binding upon the IRS Defendants and PUC Defendants as to whether implementation of the Decision would render Pacific ineligible for accelerated depreciation and the investment tax credit.

WHEREFORE, plaintiff Pacific prays for judgment against defendants as follows:

As to Count I Against the PUC Defendants:

1. That the Court enter a temporary restraining order restraining and enjoining the PUC Defendants, and each of them, and their agents, servants and employees and attorneys, and all persons acting in concert with them, from enforcing, executing or making effective the Decision;

2. That the Court enter an order requiring the PUC Defendants, and each of them, to show cause, if any there may be, why a preliminary injunction should not issue re-

straining and enjoining the PUC Defendants, and each of them, and their agents, servants and employees and attorneys, and all persons acting in concert with them, from enforcing, executing, or making effective the Decision, until such time as Pacific's eligibility for accelerated depreciation and the investment tax credit under the Decision is definitively determined in a manner binding upon the IRS;

3. That upon trial of the issues of this Count I on the merits, the Court makes such preliminary injunction permanent until such time as Pacific's eligibility for accelerated depreciation and the investment tax credit under the Decision is definitively determined in a manner binding upon the IRS;

4. That in the event it is definitively determined that the Decision would render Pacific ineligible for accelerated depreciation and the investment tax credit, that the Court make such preliminary injunction permanent; and

5. That this Court establish appropriate procedures to ensure that the determination of the tax issues is being diligently pursued by Pacific.

As to Count II Against All Defendants:

1. That judgment be entered by this Court binding upon the IRS Defendants and the PUC Defendants declaring whether implementation of the Decision would render Pacific ineligible for the accelerated depreciation and the investment tax credit.

2. That in the event it is declared by this Court that the implementation of the Decision would render Pacific ineligible for accelerated depreciation and the investment tax credit, that this Court issue a permanent injunction restraining and enjoining the PUC Defendants, and each of them, and their agents, servants and employees and attorneys, and all persons acting in concert with them, from enforcing, executing, or making effective the Decision.

As to the Counts Against All Defendants:

1. For costs of suit; and

2. For such other and further relief as this Court may deem just and proper.

DATED: March 15, 1979

WYMAN, BAUTZER, ROTHMAN & KUCHEL
By /s/ FRANK ROTHMAN
Frank Rothman

Attorneys for Plaintiff The Pacific Telephone and Telegraph Company

Of Counsel:

Robert V. R. Dalenberg
140 New Montgomery Street
San Francisco, California 94105
(415) 542-1581

Verification

I, Robert M. Joses, declare and say as follows:

1. I am the Treasurer of The Pacific Telephone and Telegraph Company, plaintiff in the above-entitled action or proceeding. I have read the foregoing Complaint and know the contents thereof. I am informed and believe that the matters therein stated are true and, on that basis, allege them to be true.

I declare under penalty of perjury that the foregoing is true and correct.

Executed this 15 day of March, 1979, in Los Angeles, California.

/s/ Robert M. Joses
Robert M. Joses

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

No. 79-1024 R

General Telephone Company of California,
a California corporation,
Plaintiff,

vs.

Public Utilities Commission of the State of California; and John E. Bryson, Claire T. Dedrick, Richard D. Gravelle, Vernon L. Sturgeon, and Leonard M. Grimes in their capacities as members of the Public Utilities Commission; W. Michael Blumenthal, Secretary of the Treasury, an agency of the United States of America; and Jerome Kurtz, Commissioner, Internal Revenue Service, an agency of the United States of America,
Defendants.

Complaint to Enjoin Violation of Federal Statutes and the Constitution of the United States of America; and for Declaratory Relief

General Telephone Company of California ("General") alleges for its complaint, as follows:

Parties and Jurisdiction

1. General is a corporation organized and existing under the laws of the State of California and authorized to do

business in the State of California, and doing business within the Central District of California.

2. Defendant PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA ("Commission") is a political subdivision of the State of California, created and existing under Article 12 of the Constitution of the State of California. The Commission is empowered to administer the provisions of the California Public Utilities Code ("Code"). Defendants JOHN E. BRYSON, CLAIRE T. DEDEICK, RICHARD D. GRAVELLE, VERNON L. STURGEON, and LEONARD M. GRIMES are the present individual members of the Commission. Defendant Commission and defendants, Bryson, Dedrick, Gravelle, Sturgeon and Grimes are sometimes referred to collectively herein as the ("P.U.C. Defendants").

3. W. MICHAEL BLUMENTHAL is Secretary of the Treasury and principal administrator of the Department of the Treasury, an agency of the United States of America. Defendant JEROME KURTZ is Commissioner of the Internal Revenue Service ("IRS"), an agency of the United States of America. The defendants named in this paragraph are sometimes referred to collectively herein as the ("IRS Defendants".)

4. General is lawfully engaged in rendering a public utility service in the State of California, subject to the provisions of the Code. It is engaged in the business of supplying exchange and toll telephone service within certain areas of the State of California, as well as telephone service between telephone stations in the State of California and stations in other states of the United States and in foreign countries. The tolls, charges, rates, and other practices of General for intrastate telephone service within the State of California are subject to regulation by the Commission under the Code. The tolls, charges, rates, and other practices of General for interstate telephone service are subject to regulation by the Federal Communications Commission.

5. This Court has jurisdiction of the subject matter of this action pursuant to Title 28 U.S.C. § 1331 in that this is a civil action wherein the matter in controversy exceeds the sum or value of ten thousand dollars ($10,000), exclusive of interest and costs, and arises under the statutes and Constitution of the United States; pursuant to Title 28 U.S.C. § 1340 in that this is a civil action arising under an Act of Congress providing for internal revenue; and pursuant to the Declaratory Judgment Act, 28 U.S.C. § 2201. Plaintiff does not have any other plain, speedy or efficient remedy for reasons hereinafter set forth.

6. Venue is properly laid in this District pursuant to Title 28 U.S.C. § 1391(b) in that the P.U.C. Defendants, and each of them, in their official capacities, reside in this District; pursuant to Title 28 U.S.C. § 1391(e) in that the Defendants W. MICHAEL BLUMENTHAL and JEROME KURTZ, and each of them, in their official capacities, are officers of agencies of the United States; and pursuant to Title 28 U.S.C. § 1391(b) and Title 28 U.S.C. § 1391(e) in that the claim which is the subject of this complaint arose in this District.

Count I

Against the P.U.C. Defendants to Enjoin the Violation of Federal Statutes and The Constitution of the United States of America

7. Since 1954 the Federal tax laws have permitted taxpayers to use accelerated depreciation in computing income for Federal tax purposes. In certain circumstances the use of accelerated depreciation defers taxes. On January 1, 1970, Internal Revenue Code Section 167(l) became effective. That section and Treasury Regulations promulgated thereunder declare that a taxpayer in General's position is eligible for accelerated depreciation only if the agency that sets its rates (the Commission in this case) uses the "Normalization" method of accounting for ratemaking purposes. Normalization Accounting provides a

way of passing on to the ratepayers each year through rate reductions a portion of the taxes that the utility has deferred as a result of using accelerated depreciation. Therefore, if the Commission were to order General to reduce its rates on account of General's use of accelerated depreciation for tax purposes beyond the amount permitted under Normalization Accounting, General would *ipso facto* become ineligible for accelerated depreciation for tax purposes.

8. In December, 1971, Internal Revenue Code Section 46 became effective. That section confers upon taxpayers the right to receive a credit against income taxes otherwise payable (the "investment tax credit"), based upon amounts invested during the tax year in newly acquired plant and equipment. Section 46(f) and Treasury Regulations promulgated thereunder declare that a taxpayer in General's position is eligible for the investment tax credit only if the agency that sets its rates uses the "Ratable Flow-Through" method of accounting. Ratable Flow-Through provides a way of passing on to the ratepayers each year through rate reductions a portion of the taxes that the utility has saved as a result of its receipt of investment tax credits. Therefore, if the Commission were to order General to reduce its rates on account of General's receipt of investment tax credits beyond the amount permitted by Ratable Flow-Through, General would *ipso facto* become ineligible for the investment tax credit.

9. General has used accelerated depreciation in computing its income for tax purposes in all tax years beginning with 1970, it has claimed the investment tax credit in all tax years beginning with 1972, and it has paid its taxes accordingly. Except as hereinabove otherwise stated, the Commission has at all revelant times used Normalization Accounting and Ratable Flow-Through in setting General's rates, subject, however, to later refund should the Commission ultimately decide for ratemaking purposes to account in some other manner for General's use of accelerated depreciation and investment tax credit. As a consequence, up to the present time, General has been eligible for accelerated depreciation and the investment tax credit.

10. By reason of the facts alleged in Paragraph 9 in the years 1970 through 1977 General has deferred or saved a total of $211,084,000 in Federal income taxes and, unless its eligibility is disallowed, by year end 1983 the deferral or savings will grow to approximately $619,054,000. Also, the revenues General has collected from its ratepayers during the years 1970 through 1977 have been reduced by an aggregate amount of approximately $50,000,000 through the use of Normalization Accounting and Ratable Flow-Through in setting its rates and with normal rate case procedures will by 1983 equate to a rate decrease of approximately $88,000,000 per annum.

11. General has waived the running of the statute of limitations on its Federal tax returns for the years 1970 to date. Hence these returns remain open for audit and deficiency assessment by the IRS Defendants. In particular, General's eligibility for accelerated depreciation and the investment tax credit in tax years 1970 to date remains open to challenge by the IRS Defendants, should the Commission order General to refund to its ratepayers any portion of the tariffs it collected during those years because of the adoption by the Commission of a method of accounting other than Normalization Accounting and Ratable Flow-Through for ratemaking purposes.

12. On September 13, 1977 the Commission entered Decision No. 87838 (the "Decision") a copy of which is attached as Exhibit A. The Decision orders General to refund the sum of $65,440,000 to its ratepayers, on account of tariffs collected by General subject to refund in the years 1970 through 1977, and to implement rate reductions in subsequent years which will grow from approximately $13,000,000 to 1978 to approximately $40,000,000 by 1983.

Said refunds and reductions result from the use by the Commission for ratemaking purposes of methods of accounting called the "Averaged Annual Adjustment" and "Annual Adjustment" in lieu of Normalization Accounting and Ratable Flow-Through, respectively. The use of the Averaged Annual Adjustment and Annual Adjustment in setting General's rates reduce them on account of its use of accelerated depreciation and of its receipt of investment tax credit beyond the amount permitted under Normalization Accounting and Ratable Flow-Through, respectively, by the amounts hereinabove stated. Decision No. 87838 also applies to the Pacific Telephone and Telegraph Company ("Pacific"), which is in the same position as General, with exactly the same force and effect except that the refunds and reductions that Pacific would have to make under the Decision would be greater, and Pacific's refunds only go back to the year 1974.

13. On July 13, 1978, the California Supreme Court denied without a written opinion petitions for a writ of review of the of the Decision filed by General and Pacific.

14. On December 11, 1978, the United States Supreme Court denied petitions for writ of *certiorari* filed by General and Pacific seeking review of the Decision.

15. By virtue of petitions and orders timely made, the Decision was suspended until March 13, 1979.

16. The Commission expressly predicated the Decision upon the premise that the use of the Average Annual Adjustment and Annual Adjustments methods of accounting which the Decision utilizes in setting General's and Pacific's rates are consistent with IRC § 167(l) and IRC § 46(f) and Treasury Regulations adopted thereunder. In fact, General is informed and believes and therefore alleges that in so ruling the P.U.C. Defendants misinterpreted IRC 167(l) and 46(f); that said methods of accounting are inconsistent with the requirements of the IRC § 167(l) and

§ 46(f); that the Decision, if implemented, will destroy General's eligibility for accelerated depreciation and the investment tax credit both retroactively to 1970 and prospectively; and that said Decision will frustrate and negate the purpose of the Congress in enacting IRC § 167(l) and § 46(f). The IRS Defendants were not and could not have been made parties to the proceedings that resulted in Decision No. 87838 and they are not bound by it. In rulings issued on June 9 and August 9, 1978, the IRS notified General that implementation of the Decision will in fact deprive General of its eligibility for said tax benefits. True and correct copies of such rulings are attached hereto as Exhibits B and C. The IRS issued identical rulings to Pacific.

17. If the Decision is permitted to go into effect, and if the understanding and assumption of the P.U.C. Defendants as to the meaning of the Internal Revenue Code is subsequently determined to be incorrect, General will be grossly and irreparably injured, in that:

(a) The revenues General has collected during the years 1970 through 1977 will have been reduced by approximately $50,000,000 through the use of Normalization Accounting and Ratable Flow-Through in setting its rates, and it will have refunded to its ratepayers the additional sum of $65,440,000 required by the Decision;

(b) The revenues General will have collected and will continue to collect in 1978 and subsequently will have been reduced by an increasing amount with the passage of time up to approximately $88,000,000 in 1983 through the use of Normalization Accounting and Ratable Flow-Through in setting its rates and will have been reduced by an additional amount each year under the mandate of the Decision, beginning with approximately $13,000,000 in 1978 and growing to approximately $40,000,000 by 1983.

(c) While the only justification for such refunds and reductions is to pass on to General's ratepayers a portion of tax deferrals and savings General supposedly has heretofore enjoyed and is expected hereafter to enjoy through the use of accelerated depreciation and the receipt of the investment tax credit, General is informed and believes and therefore alleges that the making of any part of the refunds or reductions required by the Decision will *ipso facto* destroy General's eligibility for accelerated depreciation and the investment tax credit and hence for said supposed tax savings and deferrals, that General will become liable to the United States for back taxes and interest for all deductions and credits previously taken by General in tax years 1970 to date which were premised upon General's eligibility for accelerated depreciation and the investment tax credit, and their General will be ineligible for any such deductions or credits in subsequent years. General's potential tax liability for the years 1970 through 1977 would approximate $211,084,000 plus $32,000,000 in accrued interest, and the amount of deductions and credits for which General will be rendered ineligible in subsequent years would grow to approximately $619,054,000 by year end 1983, plus $159,000,000 in accrued interest. As a consequence, General will have passed on to its ratepayers and will be required to continue passing on to its ratepayers supposed tax savings and deferrals which it does not in fact enjoy.

18. General is informed and believes and therefore alleges that under current California law the Commission may not adjust General's rates in the future so as to enable it to recoup refunds previously made even though the refund was ordered by the Commission, nor to recoup revenue lost through the reduction of rates made pursuant to the order of the Commission. Therefore, if the injunction

requested herein is denied and the refunds and rate reductions mandated by the Decision are implemented and cause General to lose its eligibility for accelerated depreciation and the investment tax credit in the tax years affected by the Decision, General will never be able to restore its lost eligibility.

19. If the Decision is permitted to go into effect prior to a determination of the tax questions in a manner binding upon the IRS, and if, as the IRS has indicated, General is found to be ineligible for accelerated depreciation and the investment credit:

(a) General will have been deprived of rights the Congress sought to confer upon taxpayers in General's position;

(b) The purpose of the Congress in enacting IRC § 167(l) and § 46(f) will have been frustrated and negated by the actions of the Commission in violation of Article VI, Section 2 of the United States Constitution;

(c) General's rate of return for each year affected by the Decision will be reduced to a confiscatory low level, thereby depriving General of its property without a proper purpose and without just compensation in violation of the Fifth and Fourteenth Amendments of the United States Constitution;

(d) General's ability to provide intrastate and interstate telephone service will be impaired;

(e) General will be denied the right to meaningful judicial review of the relevant provisions of the Internal Revenue Code and the interrelationship of such provisions to the propriety of the Decision, in that if the interpretation of the Internal Revenue Code espoused by the P.U.C. Defendants and upon which the Decision is premised is erroneous, General cannot

obtain meaningful relief from the consequences of the error of the P.U.C. Defendants.

20. General is informed and believes and therefore alleges that if the effectiveness and enforcement of the Decision is stayed by this Court, timely procedures under the Internal Revenue Code will become available and will be invoked in the immediate future whereby the entitlement of taxpayers in General's position to accelerated depreciation and the investment tax credit may be determined in an action that will be binding on the IRS Defendants.

21. As a result of the foregoing, General respectfully submits that this Court should enter an Order restraining and enjoining the P.U.C. Defendants, and each of them, from enforcing, executing or making effective the Decision, until such time as General's eligibility for accelerated depreciation and the investment tax credit under the Decision is definitively determined in a proceeding under the Internal Revenue Code in a manner binding upon the IRS Defendants. Further, in the event that such determination is to the effect that the Decision destroys General's eligibility for accelerated depreciation and the investment tax credit and in the further event that the P.U.C. Defendants do not thereupon withdraw or modify the Decision so as to preserve General's eligibility, then in such event General respectfully submits that this Court make its said Order permanent. The failure by this Court to provide such relief will cause General irreparable injury and leave General without any plain, speedy or efficient remedy; General has no adequate remedy at law. The Decision is repugnant to Sections 167(l) and 46(f) of Title 28 of the United States Code, and to the Taking, Due Process and Supremacy Clauses of the United States Constitution and it will, moreover, impose an undue and unlawful burden on interstate commerce.

Count II

Against All Defendants for Declaratory Relief

22. General alleges and incorporates by reference Paragraphs 1 through 21 of this complaint as if set forth in full herein.

23. In the event the Court determines that timely procedures under the Internal Revenue Code do not exist whereby General's entitlement to accelerated depreciation and investment tax credit may be determined in a manner which will be binding upon the IRS Defendants, then in that event plaintiff respectfully submits that this Court should issue its declaratory judgment herein, binding upon the IRS Defendants and the P.U.C. Defendants, as to whether implementation of the Decision would render General ineligible for accelerated depreciation and the investment tax credit.

WHEREFORE, plaintiff prays for judgment against defendants as follows:

As to Count I Against the PUC Defendants:

1. That the Court enter a temporary restraining order restraining and enjoining the P.U.C. Defendants, and each of them, and their agents, servants and employees and attorneys, and all persons acting in concert with them, from enforcing, executing or making effective the Decision.

2. That the Court enter an order requiring the P.U.C. Defendants, and each of them, to show cause, if any there may be, why a preliminary injunction should not issue a restraining and enjoining the P.U.C. Defendants, and each of them, and their agents, servants and employees and attorneys, and all persons acting in concert with them, from enforcing, executing, or making effective the Decision, until such time as General's eligibility for accelerated depreciation and the investment tax credit under the Decision is de-

finitively determined in a manner binding upon the IRS Defendants.

3. That in the event it is definitively determined that the Decision would render General ineligible for accelerated depreciation and the investment tax credit, that the Court make such preliminary injunction permanent; and

4. That this Court establish appropriate procedures to ensure that the determination of the tax issues is being diligently pursued by General.

As to Count II Against All Defendants:

1. That judgment be entered by this Court binding upon the IRS Defendants and the P.U.C. Defendants declaring whether the implementation of the Decision would render General ineligible for the accelerated depreciation and the investment tax credit.

2. That in the event it is declared by this Court that the implementation of the Decision would render General ineligible for accelerated depreciation or the investment tax credit, that this Court issue a permanent injunction restraining and enjoining the P.U.C. Defendants, and each of them, and their agents, servants and employees and attorneys, and all persons acting in concert with them, from enforcing, executing, or making effective the Decision.

As to Counts Against All Defendants:

1. For costs of suit; and

2. For such other and further relief as this Court may deem just and proper.

Dated: March 14, 1979

O'MELVENY & MYERS
EVERETT B. CLARY
CLARK WADDOUPS

By /s/ EVERETT B. CLARY
Everett B. Clary

Attorneys for Plaintiff,
General Telephone Company of California

Of Counsel:

ALBERT M. HART
100 Wilshire Boulevard
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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

No. 79-1024

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY,
a California corporation,
Plaintiff,

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA; CLAIRE T. DEDRICK, RICHARD D. GRAVELLE, VERNON STURGEON, LEONARD GRIMES, JR., and JOHN BRYSON, in their capacities as members of the Public Utilities Commission; W. MICHAEL BLUMENTHAL, Secretary of the Treasury, an agency of the United States of America; and JEROME KURTZ, Commissioner, Internal Revenue Service, an agency of the United States of America,
Defendants.

Affidavit of Robert M. Joses

STATE OF CALIFORNIA)
City and County of San Francisco) ss.

ROBERT M. JOSES, being first duly sworn, deposes and says:

I am Treasurer of The Pacific Telephone and Telegraph Company ("Pacific") with offices at 140 New Montgomery

Street, San Francisco, California. I have been Treasurer of Pacific since February, 1972. I am familiar with the proceedings before the Public Utilities Commission of the State of California (the "Commission") that are the subject of this action. I am also familiar with the financial and tax affairs of Pacific.

1. In Decision No. 87838 (herein the "Decision"), the Commission effectively reduced Pacific's rates from August 17, 1974 onward by adopting new ratemaking methods with respect to certain federal income tax deductions (accelerated depreciation and the investment tax credit), for which deductions the Commission presumes Pacific will remain eligible under the Decision. (I use below the term "tax benefits" to refer to the use of accelerated depreciation and the investment tax credit). In the most recent year (1978), the effect of the several ratemaking methods upon the Commission's assumption of eligibility was to reduce Pacific's rates by about $148,000,000 per year.

2. If the Decision is implemented, the mandated reduction in rates effective from 1974 on (including refunds resulting therefrom) cannot, as a practical matter, ever be recouped by Pacific, even if the Decision is reversed, withdrawn or modified at some future time. From August, 1974 until January, 1979 the cumulative amount of the rate reductions resulting from the new ratemaking methods, coupled with otherwise proper rate reductions attributable to the tax benefits, comes to approximately $494,000,000. Furthermore, the rate reductions mandated by the Decision will continue on into the future for an indeterminate period of time.

3. On its federal income tax returns Pacific has claimed accelerated depreciation since 1970 and investment tax credit since 1971. The Decision was based on the Commission's explicit finding that Pacific would continue to be eligible for the tax benefits if the new ratemaking methods were applied. However, the Internal Revenue Service on June 8 and July 27, 1978 issued rulings which state that Pacific

will not be eligible to use accelerated methods of depreciation and the investment tax credit if the Decision is implemented. Copies of those rulings are attached to the Complaint filed in this action as Exhibits "C" and "D". The Solicitor General of the United States reviewed the matter and confirmed that the rulings express the position of the United States of America in a memorandum filed with the United States Supreme Court, a copy of which is attached to the Memorandum of Points and Authorities filed concurrently herewith in this action as Exhibit "2".

4. The Internal Revenue Service is presently conducting an audit of tax years 1974, 1975 and 1976. I estimate that that audit will be completed in the latter part of 1979. Those three years involve approximately $484,000,000 of possible tax liability (exclusive of interest) which would be incurred if the Internal Revenue Service prevails in its position that implementation of the Decision will cause Pacific to become ineligible for the tax benefits.

5. The possible tax liability represented by the accrual of deferred taxes associated with accelerated depreciation and the investment tax credit claimed since the beginning of 1974 is shown below. The actual amounts are shown through 1977 and estimated amounts thereafter through 1983. These figures do not include interest.

	Reserve For Deferred Taxes	Investment Tax Credit	Annual Total
1974	$ 91,132,000	$ 26,313,000	$ 117,445,000
1975	106,454,000	69,675,000	176,129,000
1976	116,428,000	73,847,000	190,275,000
1977	131,315,000	84,454,000	215,769,000
1978 (est.)	142,095,000	103,875,000	245,970,000
1979 (est.)	146,485,000	122,589,000	269,074,000
1980 (est.)	166,704,000	128,793,000	295,497,000
1981 (est.)	188,132,000	140,369,000	328,501,000
1982 (est.)	212,039,000	150,795,000	362,834,000
1983 (est.)	262,986,000	158,049,000	421,035,000
GRAND TOTAL	$1,563,770,000	$1,058,759,000	$2,622,529,000

6. It is probable that when the audits for 1974, 1975 and 1976 are completed, the Internal Revenue Service will assert deficiencies based upon the Service's previous rulings that the Decision will cause Pacific to lose its eligibility for the tax benefits. Such audits should be completed in the fall of 1979. Even if the Decision is stayed, I believe the Internal Revenue Service will assert a deficiency related to tax eligibility, and that this will permit Pacific to contest the matter. If Pacific wishes to contest those deficiencies it may pay the tax and sue for a refund in the United States District Court, or it may choose not to pay the tax and bring a proceeding in the United States Tax Court.

At the conclusion of the Tax Court litigation, if the position of the Internal Revenue Service is upheld, Pacific will be required to pay something in excess of $700,000,000 relating to those three years. At that time Pacific may be forced to file its future tax returns without claiming accelerated depreciation or the investment tax credit (even though the Commission has set Pacific's rates on the assumption of eligibility for the tax benefits). In addition, the Internal Revenue Service may insist that Pacific file amended returns for all tax years subsequent to 1976. These amended returns would show the effect of the disallowance of accelerated depreciation and the investment tax credit. With the filing of such amended tax returns the Service may insist upon the payment of the tax shown due by the amended returns. Under those circumstances Pacific will be faced with paying the entire tax deficiency for all years at or shortly after the time litigation is concluded with respect to the years 1974, 1975 and 1976. I estimate that result will come about some time between mid-1982 and the end of 1983 and for computation purposes have used the date of December 31, 1983.

By then the total back tax liability that Pacific would face from 1974 through the end of 1983 (including interest) will be in excess of $3 billion (See Exhibit "A" attached hereto and incorporated by reference herein for such com-

putation). It would be necessary to pay that liability through some form of debt financing for it is unlikely that under the circumstances equity financing would be feasible. The amount is so large that it would exhaust Pacific's ability to borrow and thus preclude it from meeting the needs of its construction program for an indeterminate time thereafter.

7. If the Decision is placed in effect, the Internal Revenue Service may instead take the position that the amended tax returns are due currently, in which event the total present back tax liability of approximately $946,000,000 (plus interest) would be due. The Internal Revenue Service position would be based on Treasury Regulations § 1.167(1)-1(5) which provide, in part:

> "Change in method of regulated accounting. The taxpayer shall notify the district director of a change in its method of regulated accounting, an order by a regulatory body or court that such method be changed, or an interim or final rate determination by a regulatory body which determination is inconsistent with the method of regulated accounting used by the taxpayer immediately prior to the effective date of such rate determination. Such notification shall be made within 90 days of the date that the change in method, the order, or the determination is effective. In the case of a change in the method of regulating accounting, the taxpayer shall recompute its tax liability for any affected taxable year and such recomputation shall be made in the form of an amended return where necessary unless the taxpayer and the district director have consented in writing to extend the time for assessment of tax with respect to the issue of normalization method of regulated accounting."

If the full tax must be paid at essentially one time, either now or later, the required financing will be immensely disruptive of Pacific's normal financial affairs and jeopardize

the level of the construction program. This in turn would severely injure telephone service and irreparably injure Pacific.

8. Pacific's operational planning spans a future five year period. Our current estimate calls for construction programs as shown below (assuming continued eligibility for the tax benefits):

Year	*Amount*
1979	$2.1 Billion
1980	$2.2 Billion
1981	$2.4 Billion
1982	$2.6 Billion
1983	$2.7 Billion

In 1976, when the Commission took evidence in this case, Pacific's construction program was $1.1 billion for that year.

Assuming eligibility for the tax benefits, I estimate that the construction program and securities refunding requirements can be met by using internally generated funds and externally secured capital as indicated in the table attached as Exhibit "B" hereto and incorporated by reference herein.

9. Raising the capital necessary to pay the back tax liability imposed as a result of being rendered ineligible for the tax benefits (and paying the carrying charges) would force Pacific to curtail its expenditures for new construction and operating expenses, including maintenance. The severe reductions required would necessarily mean that an increasing number of telephone calls, both interstate and intrastate long distance and local, would fail to be completed promptly or fail to go through at all because of lack of sufficient circuits and equipment failures. The number of held orders for customers who want but cannot be provided with service because of lack of plant capacity

would increase dramatically. This increase in held orders would impact most heavily on people and businesses who move into or within the State and request new service for the first time, although existing customers and residents would also suffer as their requirements for telephone service expand. Moreover, the existence of California businesses without telephone service or inadequate service would pose problems to individuals and businesses in other states attempting to contact or do business with them.

10. The combined effect of the refunds and rate reductions and the probability that eligibility for the tax benefits will be lost has already resulted in making Pacific a substantially more risky enterprise and thereby has caused Pacific to pay higher rates of interest for its borrowings than would otherwise be the case. This effect was discounted by the financial markets so long as the Commission's Decision was suspended and under court review. If the Decision is in fact placed in effect while the eligibility question is unresolved, Pacific will experience greater and greater difficulty in raising capital at a time when it will need more and more money to fill its growing construction program requirements.

Even while the issue has been in litigation the security rating agencies have recognized the growing financial risk and have reduced Pacific's rating:

Standard & Poor's

May 1973 From AAA to AA
Oct. 1977 From AA to AA–
June 1978 From AA– to A+

Moody's

Dec. 1977 From Aaa to Aa
Jan. 1979 From Aa to A

11. If the Decision is stayed, the refunds and rate reductions will not take place until after a definite determination

of the impact of the Decision on Pacific's eligibility for the tax benefits, and the cost of financing will be considerably less than it would be if the Decision remains in effect. The financial community will recognize that the stay preserves the Commission's ability to revise the Decision to preserve eligibility. If the Decision is stayed, and if the outcome of the tax litigation is a final determination that Pacific would not be eligible for the tax benefits under the Decision, the Commission would then be able to modify the Decision to preserve eligibility and thereby avoid the immense tax liability outlined above.

12. Pacific has been marketing its debt securities in very large sums—i.e. $300,000,000 at a time. The first result which placing the Decision in effect will bring about will be a further deterioration in Pacific's credit standing and an increase in the cost of capital related to the increased financial risk. This will be followed by an inability to sell securities in as large amounts and it is probable that Pacific will not be able to market anything approaching $300,000,000 in debt securities at any one time if the Decision is placed in effect. This impact will become progressively more noticeable. As it becomes more difficult to sell such securities in large amounts, it will become increasingly difficult to raise the total amount of capital needed each year to support the construction program, since there is also a practical limitation as to how often any one issuer may go to the capital markets. It is my opinion that within a fairly short span of time Pacific will experience an even more negative market reception which will preclude it from fully funding its construction program. With a deterio-

rating credit standing there may well be times when Pacific will be unable to market its securities under any kind of reasonable terms or, possibly, at all.

/s/ ROBERT M. JOSES
Robert M. Joses

Subscribed and sworn to before me this 15th day of March, 1979.

/s/ KATHLEEN C. ALLEN
Kathleen C. Allen
NOTARY PUBLIC
State of California

EXHIBIT A

Pacific's Potential Tax Liability Resulting From Decision

Year	*Reserve for Deferred Taxes*	*Investment Tax Credit*	*Annual Total*	*Interest To 12/31/83*	*Total*
1974	$ 91,132,000	$ 26,313,000	$ 117,445,000	$ 65,427,000	$ 182,872,000
1975	106,454,000	69,675,000	176,129,000	85,643,000	261,772,000
1976	116,428,000	73,847,000	190,275,000	79,203,000	269,478,000
1977	131,315,000	84,454,000	215,769,000	74,979,000	290,748,000
1978 (est.)	142,095,000	103,875,000	245,970,000	70,716,000	316,686,000
1979 (est.)	146,485,000	122,589,000	269,074,000	61,214,000	330,288,000
1980 (est.)	166,704,000	128,793,000	295,497,000	49,496,000	344,993,000
1981 (est.)	188,132,000	140,369,000	328,501,000	35,314,000	363,815,000
1982 (est.)	212,039,000	150,795,000	362,834,000	17,235,000	380,069,000
1983 (est.)	262,986,000	158,049,000	421,035,000	—	421,035,000
GRAND TOTAL	$1,563,770,000	$1,058,759,000	$2,622,529,000	$ 539,227,000	$3,161,756,000

EXHIBIT B

Cash Requirements Assuming Eligibility And No Refunds

Year	Construction Program	Maturing Securities	Total	Internal Sources	Federal Tax Benefits (Intrastate)	External Financing
	(1)	(2)	(3 = 1+2)	(4)	(5)	(6=3–(4+5))
1979	$2,067,000,000	$110,000,000	$2,177,000,000	$ 990,000,000	$269,000,000	$918,000,000
1980	2,191,000,000	190,000,000	2,381,000,000	1,129,000,000	295,000,000	957,000,000
1981	2,391,000,000	180,000,000	2,571,000,000	1,255,000,000	329,000,000	987,000,000
1982	2,568,000,000	17,000,000	2,585,000,000	1,374,000,000	363,000,000	848,000,000
1983	2,712,000,000	99,000,000	2,811,000,000	1,472,000,000	421,000,000	918,000,000

APPENDIX C

The Fifth Amendment to the Constitution:

> No person shall be • • • deprived of life, liberty, or property, without due process of law • • • •

The Fourteenth Amendment to the Constitution:

> • • • nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

Article VI, Section 14 of the California Constitution:

> Decisions of the Supreme Court and courts of appeal that determine causes shall be in writing and with reasons stated.

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 46. AMOUNT OF CREDIT.

• • • •

(f) [as amended by Sec. 105(c), Revenue Act of 1971, P.L. 92-178, 85 Stat. 503, Sec. 302(a), Tax Reduction Act of 1975, P.L. 94-12, 89 Stat. 40, and Sec. 1906(b)(13)(A), Tax Reform Act of 1976, P.L. 94-455, 90 Stat. 1834] LIMITATION IN CASE OF CERTAIN REGULATED COMPANIES.—

(1) GENERAL RULE.—Except as otherwise provided in this subsection, no credit shall be allowed by section 38 with respect to any property described in section 50 which is public utility property (as defined in paragraph (5)) of the taxpayer—

> (A) COST OF SERVICE REDUCTION.—If the taxpayer's cost of service for ratemaking purposes is reduced by reason of any portion of the credit allowable by section 38 (determined without regard to this subsection); or
>
> (B) RATE BASE REDUCTION.—If the base to which the taxpayer's rate of return for ratemaking purposes is

applied is reduced by reason of any portion of the credit allowable by section 38 (determined without regard to this subsection).

Subparagraph (B) shall not apply if the reduction in the rate base is restored not less rapidly than ratably. If the taxpayer makes an election under this sentence within 90 days after the date of the enactment of this paragraph in the manner prescribed by the Secretary, the immediately preceding sentence shall not apply to property described in paragraph (5)(B) if any agency or instrumentality of the United States having jurisdiction for ratemaking purposes with respect to such taxpayer's trade or business referred to in paragraph (5)(B) determines that the natural domestic supply of the product furnished by the taxpayer in the course of such trade or business is insufficient to meet the present and future requirements of the domestic economy.

(2) SPECIAL RULE FOR RATABLE FLOW-THROUGH.—If the taxpayer makes an election under this paragraph within 90 days after the date of the enactment of this paragraph in the manner prescribed by the Secretary, paragraph (1) shall not apply, but no credit shall be allowed by section 38 with respect to any property described in section 50 which is public utility property (as defined in paragraph (5)) of the taxpayer—

(A) COST OF SERVICE REDUCTION.—If the taxpayer's cost of service for ratemaking purposes or in its regulated books of account is reduced by more than a ratable portion of the credit allowable by section 38 (determined without regard to this subsection), or

(B) RATE BASE REDUCTION.—If the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of the credit allowable by section 38 (determined without regard to this subsection).

• • • •

(4) LIMITATION.—

(A) IN GENERAL.—The requirements of paragraphs (1), (2), and (9) regarding cost of service and rate base adjustments shall not be applied to public utility property of the taxpayer to disallow the credit with respect to such property before the first final determination which is inconsistent with paragraph (1), (2), or (9) (as the case may be) is put into effect with respect to public utility property (to which this subsection applies) of the taxpayer. Thereupon, paragraph (1), (2), or (9) shall apply to disallow the credit with respect to public utility property (to which this subsection applies) placed in service by the taxpayer—

(i) before the date that the first final determination, or a subsequent determination, which is inconsistent with paragraph (1), (2), or (9) (as the case may be) is put into effect, and

(ii) on or after the date that a determination referred to in clause (i) is put into effect and before the date that a subsequent determination thereafter which is consistent with paragraph (1), (2), or (9) (as the case may be) is put into effect.

(B) DETERMINATIONS.—For purposes of this paragraph, a determination is a determination made with respect to public utility property (to which this subsection applies) by a governmental unit, agency, instrumentality, or commission or similar body described in subsection (c)(3)(B) which determines the effect of the credit allowed by section 38 (determined without regard to this subsection)—

(i) on the taxpayer's cost of service or rate base for ratemaking purposes, or

(ii) in the case of a taxpayer which made an election under paragraph (2) or the election described in paragraph (9), on the taxpayer's cost of

service for ratemaking purposes or in its regulated books of account or rate base for ratemaking purposes.

(C) SPECIAL RULES.—For purposes of this paragraph—

(i) a determination is final if all rights to appeal or to request a review, a rehearing, or a redetermination, have been exhausted or have lapsed.

(ii) the first final determination is the first final determination made after the date of the enactment of this subsection, and

(iii) a subsequent determination is a determination subsequent to a final determination.

(5) PUBLIC UTILITY PROPERTY.—For purposes of this subsection, the term "public utility property" means—

(A) property which is public utility property within the meaning of subsection (c)(3)(B), and

(B) property used predominantly in the trade or business of the furnishing or sale of (i) steam through a local distribution system or (ii) the transportation of gas or steam by pipeline, if the rates of such furnishing or sale are established or approved by a governmental unit, agency, instrumentality, or commission described in subsection (c)(3)(B).

(6) RATABLE PORTION.—For purposes of determining ratable restorations to base under paragraph (1) and for purposes of determining ratable portions under paragraph (2)(A), the period of time used in computing depreciation expense for purposes of reflecting operating results in the taxpayer's regulated books of account shall be used.

(7) REORGANIZATIONS, ASSETS ACQUISITIONS, ETC.—If by reason of a corporate reorganization, by reason of any other acquisition of the assets of one taxpayer by another taxpayer, by reason of the fact that any trade or business of the taxpayer is subject to ratemaking by more than one body, or by reason of other circumstances, the application of any provisions of this subsection to any public utility property does not carry out the purposes of this subsection, the Secretary shall provide by regulations for the application of such provisions in a manner consistent with the purposes of this subsection.

* * * *

SEC. 167. DEPRECIATION.

(a) GENERAL RULE.—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * * *

(*l*) [as amended by Sec. 441(a), Tax Reform Act of 1969, P.L. 91-172, 83 Stat. 625, and Sec. 1906(b)(13)(A), Tax Reform Act of 1976, P.L. 94-455, 90 Stat. 1834] REASONABLE ALLOWANCE IN CASE OF PROPERTY OF CERTAIN UTILITIES.—

(1) PRE-1970 PUBLIC UTILITY PROPERTY.—

(A) IN GENERAL.—In the case of any pre-1970 public utility property, the term "reasonable allowance" as used in subsection (a) means an allowance computed under—

(i) a subsection (*l*) method, or

(ii) the applicable 1968 method for such property.

Except as provided in subparagraph (B), clause (ii) shall apply only if the taxpayer uses a normalization method of accounting.

(B) FLOW-THROUGH METHOD OF ACCOUNTING IN CERTAIN CASES.—In the case of any pre-1970 public utility property, the taxpayer may use the applicable 1968 method for such property if—

(i) the taxpayer used a flow-through method of accounting for such property for its July 1969 accounting period, or

(ii) the first accounting period with respect to such property is after the July 1969 accounting period, and the taxpayer used a flow-through method of accounting for its July 1969 accounting period for the property on the basis of which the applicable 1968 method for the property in question is established.

(2) POST-1969 PUBLIC UTILITY PROPERTY.—In the case of any post-1969 public utility property, the term "reasonable allowance" as used in subsection (a) means an allowance computed under—

(A) a subsection (*l*) method.

(B) a method otherwise allowable under this section if the taxpayer uses a normalization method of accounting, or

(C) the applicable 1968 method, if, with respect to its pre-1970 public utility property of the same (or similar) kind most recently placed in service, the taxpayer used a flow-through method of accounting for its July 1969 accounting period.

(3) DEFINITIONS.—For purposes of this subsection—

(A) PUBLIC UTILITY PROPERTY.—The term "public utility property" means property used predominantly in the trade or business of the furnishing or sale of—

(i) electrical energy, water, or sewage disposal services.

(ii) gas or steam through a local distribution system.

(iii) telephone services, or other communication services if furnished or sold by the Communications Satellite Corporation for purposes authorized by the Communications Satellite Act of 1962 (47 U. S. C. 701), or

(iv) transportation of gas or steam by pipeline,

if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof.

(B) PRE-1970 PUBLIC UTILITY PROPERTY.—The term "pre-1970 public utility property" means property which was public utility property in the hands of any person at any time before January 1, 1970.

(C) POST-1969 PUBLIC UTILITY PROPERTY.—The term "post-1969 public utility property" means any public utility property which is not pre-1970 public utility property.

(D) APPLICABLE 1968 METHOD.—The term "applicable 1968 method" means, with respect to any public utility property—

(i) the method of depreciation used on a return with respect to such property for the latest taxable year for which a return was filed before August 1, 1969,

(ii) if clause (i) does not apply, the method used by the taxpayer on a return for the latest taxable year for which a return was filed before August 1, 1969, with respect to its public utility property of

same kind (or if there is no property of the same kind, property of the most similar kind) most recently placed in service, or

(iii) if neither clause (i) nor (ii) applies, a subsection (*l*) method.

In the case of any section 1250 property to which subsection (j) applies, the term "applicable 1968 method" means the method permitted under subsection (j) which is most nearly comparable to the applicable 1968 method determined under the preceding sentence.

(E) APPLICABLE 1968 METHOD IN CERTAIN CASES.—If the taxpayer evidenced the intent to use a method of depreciation (other than its applicable 1968 method or a subsection (*l*) method) with respect to any public property in a timely application for change of accounting method filed before August 1, 1969, or in the computation of its tax expense for purposes of reflecting operating results in its regulated books of account for its July 1969 accounting period, such other method shall be deemed to be its applicable 1968 method with respect to such property and public utility property of the same (or similar) kind subsequently placed in service.

(F) SUBSECTION (*l*) METHOD.—The term "subsection (*l*) method" means any method determined by the Secretary to result in a reasonable allowance under subsection (a), other than (i) a declining balance method, (ii) the sum of the years-digits method, or (iii) any other method allowable solely by reason of the application of subsection (b)(4) or (j)(1)(C).

(G) NORMALIZATION METHOD OF ACCOUNTING.—In order to use a normalization method of accounting with respect to any public utility property—

(i) the taxpayer must use the same method of depreciation to compute both its tax expense and its depreciation expense for purposes of establishing its cost of service for ratemaking purposes and for reflecting operating results in its regulated books of account, and

(ii) if, to compute its allowance for depreciation under this section, it uses a method of depreciation other than the method it used for the purposes described in clause (i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from the use of such different methods of depreciation.

(H) FLOW-THROUGH METHOD OF ACCOUNTING.—The taxpayer used a "flow-through method of accounting" with respect to any public utility property if it used the same method of depreciation (other than a subsection (*l*) method) to compute its allowance for depreciation under this section and to compute its tax expense for purposes of reflecting operating results in its regulated books of account.

(I) JULY 1969 ACCOUNTING PERIOD.—The term "July 1969 accounting period" means the taxpayer's latest accounting period ending before August 1, 1969, for which it computed its tax expense for purposes of reflecting operating results in its regulated books of account.

For purposes of this paragraph, different declining balance rates shall be treated as different methods of depreciation.

* * * *

(5) REORGANIZATIONS, ASSETS ACQUISITIONS, ETC.—If by reason of a corporate reorganization, by reason of any other acquisition of the assets of one taxpayer by another taxpayer, by reason of the fact that any trade or business

of the taxpayer is subject to ratemaking by more than one body, or by reason of other circumstances, the application of any provisions of this subsection to any public utility property does not carry out the purposes of this subsection, the Secretary shall provide by regulations for the application of such provisions in a manner consistent with the purposes of this subsection.

28 United States Code:

SEC. 1738. STATE AND TERRITORIAL STATUTES AND JUDICIAL PROCEEDINGS; FULL FAITH AND CREDIT.

* * * *

The records and judicial proceedings of any court of any such State, Territory or Possession * * * *

Such Acts, records and judicial proceedings * * * shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage the courts of such State, Territory or Possession from which they are taken.

APPENDIX D

MEB *

Decision No. 90094, March 14, 1979

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application No. 53587
(Filed September 19, 1972)

In the Matter of the Application of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a corporation, for authority to increase certain intrastate rates and charges applicable to telephone services furnished within the State of California.

Application No. 51774
Application No. 55214
Case No. 9503
Case No. 9802
Case No. 9832
Application No. 51904
Application No. 53935
Case No. 9100
Case No. 9504
Case No. 9578

And Related Matters.

(Re Tax Reserve Matters)

Order Denying Petition of the Pacific Telephone and Telegraph Company and General Telephone Company of California

The Pacific Telephone and Telegraph Company and General Telephone Company of California have petitioned the Commission to rehear Decision No. 89894 and to continue the suspension of Decision No. 87838 while Petitioners seek to resolve the question of eligibility for the federal tax benefits of accelerated depreciation and investment tax

credit with the United States in the federal courts and after such determination, to decide this matter.

The Cities of Los Angeles and San Diego and the City and County of San Francisco have filed a joint reply in opposition to this petition alleging, *inter alia*, that the petition is procedurely and substantively defective. TURN has also filed an opposition on similar grounds.

Decision No. 87838 was issued on September 13, 1977. Petitioners have previously sought and this Commission has denied rehearing of Decision No. 87838. The California Supreme Court has three times annulled Commission's approaches to treatment of the issues involved herein. By declining to grant petitioners' petitions for review of Decision No. 87838, the California Supreme Court has affirmed the treatment adopted in that decision. The United States Supreme Court has refused to grant certiorari in this matter. Thus the avenues of judicial review have been exhausted, and Decision No. 87838 has become final.

For these reasons, we conclude that petitioners' latest petition has no procedural basis and cannot be considered by the Commission and we deny it as improperly filed.

We have also reviewed the various contentions made in the petition to rehear Decision No. 89894, and after consideration are of the opinion that no good cause for granting the petition is set forth.

THEREFORE, IT IS ORDERED that the petition of the Pacific Telephone and Telegraph Company and General Telephone Company of California, filed February 6, 1979, is denied.

IT IS FURTHER ORDERED the refund plan and tariffs which are the subject of Decision No. 87838 be filed on March 23, 1979.

The effective date of this decision is the date hereof.

Dated at San Francisco, California, this 14th day of March, 1979.

JOHN E. BRYSON
President

RICHARD D. GRAVELLE
CLAIRE T. DEDRICK
LEONARD M. GRIMES, JR.
Commissioners

Commissioner Vernon L. Sturgeon, being necessarily absent, did not participate in the disposition of this proceeding.

I am filing a concurring opinion.
JOHN E. BRYSON

Certified as a True Copy of the Original.

A. 53587, et al.

PRESIDENT JOHN E. BRYSON, Concurring

I am persuaded that Decision No. 87838 has become final and that the Commission has no further jurisdiction to consider the telephone companies' petitions.

If the Commission had continuing jurisdiction, I would explore additional approaches to limit what the Decision termed the "staggering rate increases that are foreseeable" should the telephone companies lose eligibility for accelerated depreciation and investment tax credit under the federal tax law. However, after three California Supreme Court decisions, on the one hand, and the federal 1969 Tax Reform Act, on the other, it is uncertain whether such an approach could be found.

/s/ JOHN E. BRYSON
John E. Bryson
President

San Francisco, California
March 14, 1979

Order Denying Alternative Writ
S. F. No. 23746

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA
IN BANK

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, ETC.,
Petitioner

v.

PUBLIC UTILITIES COMMISSION, ETC., ET AL., *Respondents.*

(FILED JULY 13, 1978)

Petition for writ of Review DENIED.

Richardson, J., is of the opinion that the petition should be granted.

Motion for leave to intervene is dismissed as moot.

/s/ BIRD
Chief Justice

Order Denying Alternative Writ
S. F. No. 23743

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA
IN BANK

GENERAL TELEPHONE COMPANY OF CALIFORNIA, ETC.
Petitioner,

v.

PUBLIC UTILITIES COMMISSION, ETC., ET AL., *Respondents*

Petition for writ of Review DENIED.

Richard, J., is of the opinion that the petition should be granted.

Motion for leave to intervene is dismissed as moot.

/s/ BIRD
Chief Justice

Decision No. 87838

September 13, 1977

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Application No. 53587

(Filed September 19, 1972)

In the matter of the Application of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a corporation, for authority to increase certain intrastate rates and charges applicable to telephone services furnished within the State of California.

Application No. 51774

(Filed March 17, 1970)

In the matter of the Application of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a corporation for authority to increase certain intrastate rates and charges applicable to telephone services furnished within the State of California.

Application No. 55214

(Filed September 30, 1974;
amended December 13, 1974)

In the Matter of the Application of The Pacific Telephone and Telegraph Company, a corporation, for telephone service rate increases to offset increased wage, salary and associated expenses.

Case No. 9503

(Filed January 30, 1973)

Investigation on the Commission's own motion into the rates, tolls, rules, charges, operations, separations, prac-

tices, contracts, service and facilities of The Pacific Telephone and Telegraph Company.

Case No. 9802

(Filed November 26, 1974)

Investigation on the Commission's own motion into the rates, tolls, rules, charges, operations, separations, practices, contracts, service and facilities of the telephone operations of the Pacific Telephone and Telegraph Company.

Case No. 9832

(Filed November 26, 1974)

Investigation on the Commission's own motion into the rates, tolls, rules, charges, operations, costs, separations, inter-company settlements, contracts, service, and facilities of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a California corporation; and of all the telephone corporations listed in Appendix A, attached hereto.

Application No. 51904

(Filed May 15, 1970;
amended July 17, 1970)

In the Matter of the Application of General Telephone Company of California, a corporation, for authority to increase its rates and charges for telephone service.

Application No. 53935

(Filed March 28, 1973)

In the Matter of the Application of General Telephone Company of California, a corporation, for authority to increase its rates and charges for telephone service.

Case No. 9100

(Filed August 4, 1970)

Investigation on the Commission's own motion into the rates, tolls, rules, charges, operations, separations, practices, contracts, service and facilities of General Telephone Company of California.

Case No. 9504

(Filed January 30, 1973)

Investigation on the Commission's own motion into the rates, tolls, rules, charges, operations, separations, practices, contracts, service and facilities of the telephone operations of all the telephone corporations listed in Appendix A, attached hereto.

Case No. 9578

(Filed July 3, 1973)

Investigation on the Commission's own motion into the rates, tolls, rules, charges, operations, costs, separations, practices, contracts, service, and facilities of GENERAL TELEPHONE COMPANY OF CALIFORNIA, a California corporation; and of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a California corporation; and of all the telephone corporations listed in Appendix A, attached hereto.

(Appearances are listed in Appendix A.)

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Opinion

This is the latest, and hopefully the final, proceeding on the long and tortuous road involving the regulatory rate treatment of accelerated tax depreciation (which includes asset depreciation range, class life system, salvage value, and repair allowance) and the Job Development Investment Credit, now called the Investment Tax Credit (ITC), for two major California telephone utilities, The Pacific Telephone and Telegraph Company (Pacific), and General Telephone Company of California (General). This proceeding results directly from the remand by the California Supreme Court in *City of Los Angeles* v. *Public Utilities Commission* (1975) 15 C 3d 680, which annulled that portion of the rate increase granted Pacific in D.83162 dated July 23, 1974 which related to accelerated tax depreciation and ITC. (All other matters decided in D.83162 were affirmed by the court). This annulment also applied to General because in D.83778 dated November 26, 1974 General's accelerated tax depreciation and ITC were treated by this Commission in the same manner as was Pacific's in D. 83162.

At the time the above decision was filed by the court, there was under submission another rate increase proceeding for Pacific, A.55214, in which we issued D.85287 on December 30, 1975. D.85287 granted a rate increase subject to refund to provide for any adjustment in the rates that might be required as a result of the hearings in the instant proceeding. In addition, at the time this matter was remanded by the court two rate increase applications, A.55492 for Pacific and A.55383 for General, were pending. The accelerated depreciation and ITC issues in those pro-

ceedings were removed for final determination in this proceeding.

In the remanded matters this Commission had set rates based on the normalization method of accounting,[1] which involves the computation of rates based on the same method of depreciation, both for depreciation expense and federal income tax expense, while the federal income taxes are actually paid on the basis of a different amount of (accelerated) depreciation expense. Since accelerated depreciation substantially increases the allowable expenses to the utility, the taxable income, and therefore the federal income tax expense of the utility, is substantially below what it would have been had taxes been paid on the ratemaking (straight-line) depreciation basis. The difference between the amount of taxes computed on a straight-line depreciation basis and an accelerated depreciation basis is reflected in a reserve account called the deferred tax reserve. This amount, on an average basis, is deducted from rate base so that the authorized rate of return is not earned on this sum. The deferred tax reserve accumulates from year to year disproportionately to revenues, expenses, and

[1] Internal Revenue Code (IRC) Section 167(*l*)(3)(G), which reads as follows:

"(G) Normalization method of accounting.—In order to use normalization method of accounting with respect to any public utility property——

(i) the taxpayer must use the same method of depreciation to compute both its tax expense and its depreciation expense for purposes of establishing its cost of service for ratemaking purposes and for reflecting operating results in its regulated books of account, and

(ii) if, to compute its allowance for depreciation under this section, it uses a method of depreciation other than the method it used for the purposes described in clause (i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from the use of such different methods of depreciation."

rate base as long as the overall plant additions by the utility continue to grow. To this extent, the taxes set aside in the deferred tax reserve shall never be paid and amount to an actual tax saving, rather than only a deferral. (ITC is defined as a tax credit, thus is a direct tax saving and not a deferral.)

In the remand of D.83162 the Supreme Court held, inter alia, that this Commission has the power to implement an alternative method, e.g., an annual adjustment, of tax expense treatment for accelerated depreciation and ITC. This annual adjustment method was discussed but not used in arriving at the treatment set forth in D. 83162. The Supreme Court ordered this Commission to give consideration to this method, as well as other alternatives, including the possibility of a commensurate adjustment in the rate of return, and to provide for refunds, if appropriate.

Hearings on this remand were held between March 1, 1976 and July 9, 1976 before Commissioner Robert Batinovich and Examiner Philip E. Blecher. The matter was submitted on the latter date subject to the filing of briefs.

The Proposed Report of the examiner was issued on January 19, 1977. Exceptions to the Proposed Report were timely filed by Pacific, General, City of Los Angeles (LA), and Toward Utility Rate Normalization (TURN). These exceptions shall be discussed where appropriate.[2]

Review

D.83162, 83778, and 85287 have exhaustively reviewed and discussed this tax expense issue from its inception. We shall not reiterate that discussion, but shall attempt to confine the review of evidence and discussion of the issues to those old matters still pertinent here, as well as the new matters not previously raised. However, we think a

[2] All transcript corrections requested after the date of submission by Pacific, General, and LA have been adopted.

brief recounting of three California Supreme Court decisions relating to this issue is warranted.

Case 1: City and Council of San Francisco v. Public Utilities Commission, et al. (1971) 6 C 3d 119. This case annulled D.77984, which had provided that Pacific could use accelerated depreciation with the normalization method of accounting as defined in IRC Section 167, because this Commission failed to consider lawful alternatives in the calculation of federal income tax expense. On page 130 the court said: "Because these methods involve fictitious allowances for tax expense and because they provide results which in the light of current federal income tax law are either harsh on the utility or the ratepayers, the Commission may also consider alternative approaches which strike a balance between these two extremes." This statement was quoted with approval in Case 3, infra. Since there has been no substantive change in the applicable federal tax statutes, this quotation is as appropriate today as when made.

Case 2: City of Los Angeles v. Public Utilities Commission (1972) 7 C 3d 331. A general rate increase for Pacific was annulled partly because the Commission computed taxes on the basis of normalization.

Case 3: City of Los Angeles v. Public Utilities Commission (1975) 15 C 3d 680. This is the case which remanded D.83162, et al., for these proceedings. The court stated on page 684 that the Commission took the action in D.83162 in spite of the court having annulled its previous decision in this matter for failure to consider lawful alternatives in the calculation of federal income tax expense (Case 1). The court further said that the Commission set a rate which in its own words would create a windfall for the telephone companies to the detriment to the ratepayers.

Pursuant to the remand in Case 1 the Commission entered D. 80347 dated August 8, 1972 which directed further

hearings into the tax expense problems. These further hearings had not yet been held at the time of the decision in Case 2. In D.80347 we said on page 3: "For the purpose of this opinion only we will compute Pacific's federal tax expense on the basis of accelerated depreciation with flow-through." D.80347 thus ordered a substantial refund amounting to about $176 million, including interest, based on the flow-through method of computation of the federal tax expense. D.80347 also set rates which were in effect through the effective date of D.83162 rates, which was August 17, 1974. The hearings held pursuant to Case 1 were consolidated with A.53587 and resulted in D.83162 where this Commission again adopted the normalization basis for computing federal tax expense, which resulted in Case 3.

In D.74917 dated November 6, 1968, prior to the enactment of the Tax Reform Act of 1969 (TRA) effective January 1, 1970, we determined that Pacific was imprudent in not electing the accelerated depreciation option. For ratemaking purposes we imputed accelerated depreciation with full flow-through, though Pacific was paying taxes on a straight-line basis. This procedure was approved in Case 1. TRA allowed utilities to take accelerated depreciation even though they had not taken it before 1969 only if the cost of service (which includes federal income tax expense) was computed on a normalization basis. After the enactment of TRA both Pacific and General reversed their long-standing opposition to accelerated depreciation and elected it on a normalization basis. This election has resulted in the instant proceedings in which we are attempting to comply with the mandate from our Supreme Court to reach an equitable determination of this problem.

Pacific and General argue that accelerated depreciation is allowable only if normalization accounting is used because neither is eligible under IRC Section 167.1 for flow-through accounting. If normalization is not used, then the companies must revert to straight-line depreciation and

the benefits of accelerated depreciation will be lost to both the utilities and the ratepayers. We have previously agreed with this position, as has the court in Case 1, though this result is due only to the intransigence of Pacific and General in not opting for accelerated depreciation when they had the opportunity. While this Commission deplores the actions of Pacific and General, we are again compelled to agree with their interpretation of the tax law. To impute flow-through now in attempting to redress the balance between the utilities and ratepayers, we would ultimately cause the ratepayers substantially higher rates and poorer service while seriously damaging the financial position of the companies. This horrendous result has been created by Congress through the options allowed the utilities in the tax laws, which have the effect of allowing the regulatee to regulate the regulator.

Thus, we are forced to again consider the question of maintaining eligibility for accelerated depreciation on a normalized basis. The primary reference for this purpose is Treasury Regulation 1.167(*l*)-(1)(h)(6).[3] It delineates when the normalization method of accounting is not used, and concomitantly, when it is used. If these criteria are not met, then accelerated depreciation in its entirety will be disallowed creating a huge tax liability for Pacific and General, which will be met with an equally huge deferred

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[3] This regulation, as far as pertinent, reads as follows:

"(6) Exclusion of normalization reserve from rate base. (i) Notwithstanding the provisions of subparagraph (1) of this paragraph, a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes under section 167(*l*) which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's tax expense in computing cost of service in such ratemaking."

tax reserve account, which is paper only, as the monies credited to the deferred tax reserve have already been spent.

The same proposition prevails for ITC. Since ITC became effective in December 1971, General and Pacific have elected ratable (service-life) flow-through (Option 2).[4] This means that the amount of plant investment in the taxable year shall be apportioned on its expected service life for ratemaking purposes.

Neither Pacific nor General was eligible for ITC Option 3[5] (see Case 1, page 130), which allows full flow-through of the tax savings in the year in which the benefit occurred.

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[4] IRC Section 46(f)(2), which reads as follows:

"(2) Special rule for ratable flow-through.—If the taxpayer makes an election under this paragraph within 90 days after the date of the enactment of this paragraph in the manner prescribed by the Secretary or his delegate, paragraph (1) shall not apply, but no credit shall be allowed by section 38 with respect to any property described in section 50 which is public utility property (as defined in paragraph (5)) of the taxpayer——

"(A) Cost of service reduction.—If the taxpayer's cost of service for ratemaking purposes or in its regulated books of account is reduced by more than a ratable portion of the credit allowable by section 38 (determined without regard to this subsection), or

"(B) Rate base reduction.—If the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of the credit allowable by section 38 (determined without regard to this subsection)."

[5] IRC Section 46(f)(3), which reads as follows:

"(3) Special rule for immediate flow-through in certain cases. —In the case of property to which section 167(*l*)(2)(C) applies, if the taxpayer makes an election under this paragraph within 90 days after the date of the enactment of this paragraph in the manner prescribed by the Secretary or his delegate, paragraphs (1) and (2) shall not apply to such property."

Thus, ITC for Pacific and General will be disallowed in its entirety if the taxpayers' cost-of-service for ratemaking purposes is reduced by more than a ratable portion of the credit allowed or if the base to which the taxpayers' rate of return for ratemaking purposes is applied is reduced by more than a ratable portion of the credit.

ASSUMPTIONS

This discussion and ensuing decision reflect the assumptions set forth below:

(1) Tax Reduction Act becomes effective on January 1, 1970.

(2) As a result of Case 1 and D.80347, Pacific's rates from January 1, 1970 to August 17, 1974 have been promulgated on a flow-through basis. Since these rates are final they cannot now be amended by any action of this Commission. Therefore (a) any action taken in respect to Pacific's rates will apply from August 17, 1974 until the effective date of the rates set in D.85287, which is January 5, 1976; (b) the rates set in D.85287 are subject to refund and any action taken in this decision shall adjust those rates accordingly; and (c) any action taken here shall apply prospectively to the rates to be set in pending A.55492 of Pacific.

(3) General's rates for test year 1970 in D.79367 (effective December 12, 1971) and thereafter have been subject to refund. Therefore (a) any action taken on accelerated depreciation here shall apply to the rates collected by General from December 12, 1971; (b) although ITC was not in existence in test year 1970 used in D.79367, any action taken on ITC shall apply from December 12, 1971, as General has been taking ITC since it has been available; and (c) any action taken here on ITC

and accelerated depreciation shall apply prospectively to the rates to be set in pending A.55383 of General.

(4) Neither Pacific nor General has the option to elect accelerated depreciation on a flow-through basis under IRC Section 167, et seq. (Case 1.)

(5) Both Pacific and General must use a normalization method of accounting to maintain eligibility for accelerated depreciation under IRC Section 167, et. seq.

(6) Neither Pacific nor General has the option to elect ITC on a flow-through basis (Option 3) under IRC Section 46, et seq.

(7) Normalization accounting for accelerated depreciation reduces financial risk and increases cash flow compared to the flow-through treatment for accelerated depreciation.

(8) Both Pacific and General were guilty of imprudent management in their original determination to pay federal income taxes on a straight-line depreciation basis. (Cases 1 and 3.)

(9) The quantification of a rate of return reduction because of the increased cash flow and decreased risk and vulnerability of normalization accounting is difficult and judgmental.

THE EVIDENCE

Various alternative methods presented at the hearings may be summarized as follows:

General's Proposals

1. *Three-Year Reserve and Tax Adjustment Method.* This is a variation of a previously proposed three-year pro forma method which, it was argued, was disqualified

under Treasury Regulation 1.167(*l*)-(1)(h)(6) because it used a deferred tax reserve balance that exceeded the amount of such deferred tax reserve for the period used in determining the taxpayers' tax expense. The current proposed method remedies this defect because it considers the additional tax expense for the same period as the deferred tax reserve. It is based on the assumption that the federal income tax will increase in proportion to growth after the test year. The method of computation is as follows:

> At test year the Commission should find a reasonable federal income tax (before ITC) and a reasonable normal growth rate. (General recommends using the compound growth in main stations for the three preceding years.) The test year tax expense would then be increased by applying the growth factor to the intrastate federal income tax (before ITC) for three years into the future and averaging. The test year federal tax expense would then be deducted from the three-year average to determine the additional tax expense to be included in the test year. This amount would then be multiplied by the net-to-gross multiplier to represent the intrastate change in revenue requirement related to the additional tax expense that must be considered for the same period as the deferred tax reserve as determined in the three-year pro forma method.

2. *Annual Reserve and Tax Adjustment.* This is an adaptation of the annual or year-to-year adjustment method (which the Supreme Court discussed in Case 3), which has the same disadvantage as the pro forma method because of its use of an out-of-period deferred tax reserve. The current adaptation of this method makes an annual adjustment for the increase in reserve and also brings the additional tax expense forward for the same time period. The additional tax expense is determined in the same manner as in the three-year reserve and tax adjustment method,

but the rates would only be adjusted one year at a time. The federal income tax before ITC, plus a normal growth rate, would be determined by the Commission and each year's calculation would be based upon the prior year's calculation until a new test year was established.

3. *The Deferred Tax Reserve as No Cost Capital.* This method is used by applying the amount in the deferred tax reserve as a component of the capital structure with zero cost assigned to it. Rate base is not reduced by the amount of deferred tax reserve. The effect is to lower the cost of capital and rate of return found reasonable in general rate proceedings.

Pacific's Proposal

Annual Ratemaking Plan. Pacific would annually tender an estimated full intrastate cost of providing telephone service, keeping as constant all the ratemaking adjustments previously adopted in the latest general rate decision and the last authorized rate of return. No new adjustments or change in authorized rate of return would be permitted but all other elements of cost-of-service would be considered. This is a slightly simplified annual rate case, which everyone agrees is permitted under the existing tax laws.

Staff's Proposals [6]

1. *Pro Forma Annual Adjustment.* Gross revenue requirement reductions are determined by annual adjustments in the deferred tax reserve for the test year and each of the next three years. The average of these four years' reductions is then applied as a gross revenue reduction in test year rates.

2. *Rate of Return Adjustment—Reduced Risk.* The authorized rate of return upon which test year gross revenue

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[6] Staff refers to the Utilities Division of the Commission.

requirements are based is reduced in order to recognize the reduction of financial risk resulting from the cash flow generated by the tax savings from accelerated depreciation and ITC on a normalization accounting basis.

3. *Midpoint Flow-Through Applied to a Normalization Rate Base.* In addition to the normalized treatment of deferred tax reserve, one-half of the difference in gross revenue requirements between normalization (for accelerated depreciation) and ratable flow-through (for ITC) and a full flow-through of each is reflected in rate reductions.

4. *Normalization with Amortization of Deferred Taxes.* This is similar to the method of adjusting the expense and rate base for contributions in aid of construction. The gross revenue requirements are reduced by the reduction in rate base in the amount of the average deferred tax reserve for the test year, but the deferred tax reserve is also amortized (using the straight-line depreciation rate) by a sum also reflected in a reduction in gross revenue requirements and rates.

5. *Rate of Return Adjustment—Cost-Free Funds.* This is substantially equivalent to General's no-cost capital proposal.

The City and County of San Francisco's (SF) Proposal

SF recommends full flow-through, or in the alternative, a rate of return reduction contingent upon a favorable IRS ruling on eligibility, but in the event of an unfavorable ruling, rates to be then reset on a full flow-through basis. The purpose of this theory is to provide the companies with an incentive to obtain a favorable tax ruling, or alternatively, to amend the existing law to avoid the loss of eligibility.

The City of Los Angeles's (LA) Proposal

LA recommends a rate of return reduction up to a maximum of two percentage points,[7] while continuing the normalization treatment of tax expense. This reduction is to be quantified after considering three factors:

(1) Analysis of the financial risk reduction of a normalization as compared to a flow-through company due to the greater cash flow generated, the reduction of the need for outside financing, the reduction of the cost of embedded debt, the improvement in interest coverage, and the generally favorable effect on the cost of new capital and evalution of the utility's securities generally. (This position is supported by the city of San Diego.)

(2) The previously found imprudent management in failure to elect accelerated depreciation to avoid rewarding the utilities for their imprudence.

(3) Reflection of the phenomenon of inverse attrition, which is the opposite of the allowance for attrition that the Commission has used in the past as a regulatory tool where there is a projected diminution of the rate of return. Here, since the normalized tax reserve grows at a markedly greater rate than the other components of the utility's operations, the authorized rate of return would be exceeded in subsequent years because no reduction in rate base occurs between test years. The inverse attrition allowance set in the test year will reduce the rate of return in the future. (This is a step beyond the continuous surveillance me-

[7] For test year 1975-76, the staff calculates that the rate of return for Pacific would be 2.17 percentage points higher on a flow-through basis than on a normalization basis.

thod now in use, which only applies to earnings in excess of the authorized rate of return.)

LA recommends that ITC be treated in the same manner.

Toward Utility Rate Normalization's (TURN) Proposal

Turn proposes another method of compensating for the reduced risk of normalization by reducing the rate of return. It is calculated by discounting to present value the money which is accumulated in the deferred tax reserve and the measurement of that time value upon the rate of return allowed in addition to the normalization treatment. The method also applies to ITC using a three-year forward averaging amount (test year and two following years). In the beginning this method would produce a refund in excess of the refund produced by full flow-through.

OTHER POSITIONS

Citizens Action League (CAL). CAL supports a greater sharing of the benefits of accelerated depreciation with ratepayers than exists under normalization accounting, and urges refunds be paid in cash rather than as a bill credit.

Continental Telephone Company of California. This company would be affected by our decision here only if a refund of toll revenues collected by Pacific should be ordered.

The Los Angeles Urban League. This organization seeks equal opportunities for blacks and other minorities in all sectors of our society and is concerned over a decision adverse to Pacific which would be disastrous to Pacific's minority hiring, firing, and promotion practices under Pacific's scenario of service and construction reductions.

Los Padrinos, Inc. This is a nonprofit charitable and educational corporation of predominantly Spanish-surnamed employees of Pacific. It is also concerned about the

serious economic consequences depicted by Pacific's witnesses and urges the Commission to adopt an alternative which will preserve Pacific's eligibility for tax benefits.

The National Association for the Advancement of Colored People (NAACP). NAACP is a civil rights organization with the principal purpose of eliminating racial discrimination in every facet of American life. It urges the Commission to allow Pacific the full tax advantage of accelerated depreciation and ITC to preserve the employment of ethnic minorities and aid in employing the large number of unemployed black persons.

The Pacific Telephone Employees for Women's Affirmative Action, Southern California. This is an organization dedicated to aiding Pacific in achieving its affirmative action goals relating to women and urges action similar to the other above-mentioned groups.

DISCUSSION

One of the major difficulties in the resolution of these cases is the length of time that has transpired between the onset of the problem and its latest submission for resolution. In Case 1 the court recognized then (in 1971) that one extreme or the other in the solution would be harsh to either the utilities or the ratepayers. That proposition has now been exacerbated by the passage of years and many millions of dollars of increase in the deferred tax reserve. Now, in the event of the loss of eligibility for the tax benefits flowing from accelerated depreciation and ITC, Pacific estimates its total potential tax liability here from 1970 through the end of 1976 at $764 million, while General estimates its comparable liability at $223 million, or together almost $1 billion in potential tax liabilities. This is without regard for any rate refunds, ongoing rate reductions, and other costs that might be attributable to a retroactively assessed tax liability, such as the need for raising additional funds for plant investment, the dete-

rioration in financial position, the necessity for increased interest rates and returns on debt and equity, and a myriad of other problems involved, not the least of which are the staggering rate increases that are foreseeable as the bottom line in such a scenario. We are seeking to resolve this dilemma in a middle ground, perhaps pleasing to no one, but finally disposing of this problem by more suitably leveling the interest of the utilities and the ratekeepers. Eligibility is the first issue to be determined. To render a decision which attempts to resolve these cases without regard for this issue might create problems for these utilities, their ratepayers, the Commission, and the Courts that even exceed (both in scope and complexity) the problems that we are attempting to resolve in this decision. In the final analysis a loss of eligibility to the utilities would not only create service problems (though certainly not of the scope described by Pacific's) but would create staggering financial problems to be ultimately borne by the ratepayers whose interests we are attempting to redress. We believe that eligibility for these tax benefits should be maintained and proceed on this basis.

ACCELERATED TAX DEPRECIATION

The parties recommend various positions which encompass the entire spectrum of possibilities from maintaining the status quo with normalization to a method which would refund more money than would be available under flow-through. While the alternatives submitted are plentiful, all are substantially variations on two themes: (1) reduction of rate of return; and (2) some form of reflecting the increase in the deferred tax reserve in order to further reduce the rate base (the annual adjustment method).

The utilities would prefer to maintain the status quo, though Pacific condescended to advocate what amounts to an annual rate case, merely holding the rate of return and any other test year adjustments constant while delving

into the entire cost of service each year, a solution that will solve nothing while adding to the specter of regulatory lag.

General was somewhat more generous by offering additional variations on the annual adjustment, while offsetting the increased deferred tax reserve with increased federal tax expense.

The staff basically recommended full flow-through but as a concession to compromise supported a rate of return reduction based on reduced risk only for future rates and a refund based on full flow-through for the rates subject to refund. LA recommended a maximum two percentage point rate of return reduction for the current test year 1975-1976 for Pacific, although it supports flow-through as the only proper ratemaking approach.

For General's test year the rate of return difference between flow-through and normalization was .14 percentage points in test year 1970, 1.39 in test year 1974, and 1.58 in test year 1976. (Staff Exhibit 45.) For Pacific, the pertinent years and comparable differences are as follows: Test year 1973, 1.52 percentage points; test year ending June 30, 1976, 2.17. (Staff Exhibit 46.) The flow-through basis always produces a higher rate of return because the greater the dollar amount of depreciation differential is between straightline and accelerated depreciation, the smaller the correlative federal tax expense is for the flow-through company, and the greater the earned rate of return.

While we agree that full flow-through is the proper and best ratemaking method, we shall not consider it further because both Pacific and General would be ineligible for accelerated depreciation and ITC if rates were set on a flow-through basis. We must look to some other alternative, proposed or encompassed in the entire range of possible alternatives.

All the variations on the theme of increasing the deferred tax reserve provide readily estimable items for the purpose of computing the necessary numbers to determine the gross revenue requirements and rates. On the other hand, the reduction in rate of return is subjective, highly judgmental, and most difficult of quantification, as all the parties concede. If we were to adopt reduction in rate of return, what number would we adopt? How is this number to be determined? Is the difference in rate of return because of reduced risk merely a function of the dollar difference, as suggested by LA's witness? (Exhibit 22, page 16.) If not, what other factors are used to compute the actual number? If we adopt reduction in rate of return based on the dollar differences, as computed by the staff, what justification is used to differentiate this return from the return based on normalization accounting? Do we reason that the entire reduction in rate of return is caused by the risk reduction, as we did in D.85627 (Southern California Gas Company)?

In D.83540, the decision on petition for rehearing in D.83162, we stated on page 4: "The impact of normalization upon risk, and hence upon rate of return, was taken into account in the Commission's deliberations and was one of the factors which caused us to reduce the equity return authorized for Pacific below that authorized for other California utilities of similar capital structure. The impact or normalization on Pacific's risk was not specifically discussed because it was not disputed; all parties, including Pacific, conceded that the authorization of normalization reduces risk below that which would otherwise result. This uncontradicted evidence was taken into account in fixing rate of return." To now say that we shall again reduce rate of return in D.83162 when we already conceded that it was taken into account in setting the original rate of return would be unfair as the reduced risk would be reflected twice in rate of return. We believe it fairer to use a variation of the

annual adjustment proposed, which we will call the "averaged annual adjustment".

The theory of this method is simple: Because the increase in the deferred tax reserve is deduced from rate base, the authorized rate of return on the smaller rate base produces less revenue. The smaller amount of net revenues will then produce less tax expense since the taxable income will be decreased. Essentially, the total of the reduction in net revenues and the decreased tax expense, together with the adjustment for uncollectibles, amounts to the total gross revenue reduction.

General's expert witness testified (Exhibit 3, page 10): "If the deferred tax reserve is determined as of a time subsequent to the test period, tax expense for ratemaking purposes must be determined as of the same time." This principle is embodied in General's first alternative (pages 13 and 14, above), which remedies the alleged defect of the old pro forma method, which did not take into account tax expense for the same period used to calculate the reserve. (General's opening brief, page 16.) General's opening brief, page 16, describes the methodology, as follows: ". . . the deferred tax reserve is averaged three years into the future in the same fashion as pro forma normalization, and in addition, federal income tax expense is also averaged for the same three-year period by which test period tax expense and rate based is adjusted. The necessary correlation of the reserve and tax expense provided in the cited Treasury Regulation is thereby achieved (Exhibit 3, page 16)." This is exactly the methodology for the averaged annual adjustment.

General believes it fair to assume growth in the tax expense every year. The actual federal tax expense bears no direct relation to the increase in deferred tax reserve, but fluctuates independently of it. (Exhibit 36, Pacific; Exhibit 27, General.)[8] TR 1.167(*l*)-(1)(h)(6) does not discuss rev-

[8] In addition, the effective actual tax rate has been generally declining.

enue growth, nor the direction of federal tax expense, but only the time frame for two specific items. We think it equally fair to assume a tax expense for the averaged annual adjustment that decreases as the deferred tax reserve increases in each year to accurately reflect only the increase in deferred tax reserve in the same period of tax expense. Thus, we will hold constant all items of cost-of-service not directly dependent on the increase in deferred tax reserve. The computation starts with the test year figures. Using the latest available estimates, we will compute the reduction in net revenues resulting from the increased deferred tax reserve in each of the next three years, compute the resulting decrease in tax expense in each corresponding year, then average the deferred tax reserve and federal tax expense for the four-year period. These averaged annual adjustment figures for deferred tax reserve and federal tax expense will then be used in the current test years for the pending rate cases. For past years, the total of the decrease in net revenues and decrease in federal tax expense [9] will be deducted from the gross revenues computed under normalization accounting, and the difference shall be refunded. Tables 1 and 2 (Appendices B and C) show the method and results for Pacific and General, respectively. Total refunds through December 31, 1977 for Pacific are $110,785,000 and for General are $40,230,000. The current rate reduction is $31,609,000 for Pacific and $6,571,000 for General,[10] based on current test years and estimates for three succeeding years. The refund amounts contain interest at the rate of 7 percent per annum through December 31, 1977 from the time the rates were originally authorized and collection began. The deferred tax reserve amounts used are actual through 1976 and estimated thereafter.

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[9] A small factor shall be added as appropriate to compensate for decreased uncollectibles and franchise taxes.

[10] This amount may be adjusted for more current estimates in A.55492 for Pacific.

Pacific's opening brief (pages 42 and 43) indicates that cost-of-service must include the total tax expense [11] for the test period and the succeeding "pro forma" priod. This means the tax expense for each of the future years will have to be estimated. While Pacific agrees that the regulations do not cover how tax expense must be estimated, it indicates that the same method used to estimate future deferred tax reserve must be used to estimate future tax expense or the procedure would be suspect and subject to IRS disapproval. No authority is cited nor is any specific method of estimating proposed, nor does the IRC and the treasury regulations direct or discuss the estimating process. We believe our method is direct, simple, and in full compliance with the applicable federal law. Eligibility will be maintained since the federal tax expense for cost-of-service purposes is computed for the same period as the deferred tax reserve. While we agree that it uses a bookkeeping fiction, it is no more fictitious, no more illogical, and no more unreasonable than the fictitious theory of normalization. In *San Francisco v PUC* (1971) 6 C 3d 119, 130-131, the court said "Both of the extreme methods (normalization and flow-through) involve a fictitious charge of federal tax expense. . . Since a fictitious figure must be used under either method it is not improper for the commission to use an additional fictitious factor to limit the harsh results. Insofar as the compromise would impose a lesser burden on Pacific than is permissible consistent with due process (lesser than the burden under imputed accelerated depreciation with flow-through), Pacific is not in a position to make due process objections." We adopt this reasoning here.

The averaged annual adjustment is actually a form of annual ratemaking. It is not objectionable because it uses

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[11] General's exception to the Proposed Report makes this same point. Our discussion applies equally to this exception.

assumed constants, as these are used in an ordinary test year projection, whether or not we are considering the deferred tax reserve and the tax expense in an isolated manner. If the test year is 1970 and the rates remain in effect until the next test year, which is 1974, we have assumed that the cost-of-service has remained constant for the years 1971, 1972, and 1973. This may be unrealistic, but clearly permissible under our authority and the law. On a normalization basis, we will do the same. We will compute the deferred tax reserve and the tax expense on a normalized basis for the test year, and thereafter until the next test year those items and all other elements of cost-of-service are deemed constant. We see no difference in taking the deferred tax reserve and computing the tax expense and the rates based on those two items (and their variables) for years subsequent to the test year and averaging them back into the test year. Though the method is different, the principle is identical to the ordinary test year principle. Nor is this subject to the objection that this is a flow-through subterfuge. Everything and every method proposed by any party, including normalization as used by the companies here, is a method of flow-through. Normalization, according to Pacific, saves the ratepayers a great deal of money compared to straight-line depreciation, and there is no question that it does. But it does not approach the only sensible and realistic method of setting rates—using the actual tax expense as the cost-of-service tax expense. The method being adopted here is a more equitable and realistic method of normalization than the other proposals and the best available now.

ITC

While we agree with the Supreme Court that the effect of accelerated depreciation and ITC is identical the laws and regulations respecting them differ substantially. Thus, the specific delineation of permissible ratemaking policies in regard to maintaining ITC eligibility as set forth in IRC

Section 46, supra, requires a ratemaking treatment for ITC differing from that accorded accelerated depreciation.

There is no question that utilities which did not elect accelerated depreciation with flow-through prior to the effective date of TRA were ineligible to elect Option 3 (immediate flow-through of ITC when it became effective in December, 1971. In D.85627 (Southern California Gas Company (SoCal)), we imposed a rate of return reduction because of the reduced risk and increased cash flow generated in part as a result of SoCal's election of Option 2 for the years 1975 and 1976, when ITC was increased for those years from 4 to 10 percent for utility plant additions and from 7 to 10 percent for transmission plant additions.[12] It is our position that ITC eligibility was not affected by D.85627. However, the Internal Revenue Service (IRS), in response to a request from SoCal, issued an alleged ruling (Exhibit 52) of which we were notified by letter dated November 22, 1976. In this alleged ruling the IRS concludes that ITC will not be available to SoCal for federal income tax purposes when the benefits to be derived therefrom are treated for ratemaking purposes in the manner provided in D.85627 (as affirmed by D.86117). Our Supreme Court has granted a writ of review on SoCal's appeal of D.85627 and 86117 and has heard oral argument on the matter. While the IRS ruling is not the final determination of this issue, we believe that a rate of return reduction is not warranted in this proceeding in any event. We also, in this proceeding, reject the concept of a permanent reduction in rate of return for past as well as future rates, as recommended by some of the parties.

We do not believe a rate of return reduction to be any more of a subterfuge for accomplishing flow-through than any of the other methods presented here nor are we reject-

[12] This increase in ITC was extended through 1980 in the bill signed into law on October 4, 1976.

ing it for that reason. In a full rate case, all the elements of cost-of-service are considered in the process of arriving at a reasonable rate of return. Here, all the parties advocating this method base it solely on the number of dollars of desired refund, and not vice versa. In this proceeding, where we are addressing ourselves to changes in the level of ITC which may be expected to occur beyond the test year, we prefer a more precisely ascertainable result.[13] For these reasons we are adopting for the purposes of ITC and eligibility thereunder the only method that appears to encompass all the factors we desire, the annual adjustment. Sometime prior to the first day of each year after (and including) the test year, we shall recalculate the ITC for the coming year on the basis of the best estimates then available and shall adjust the rates accordingly at the beginning of the year to provide for the full year-to-year growth in the annual amount of ratable flow-through (Option 2). The difference in tax expense between that occurring on the test year because of Option 2 and that estimated for the adjustment year would be computed on the most recent estimate for eligible plant additions. The intrastate factor would be applied and the charge would be converted to revenue requirement by the proper net-to-gross multiplier and applied as an adjustment to decision rates for the year following the test year. Thereafter, we shall delete the earliest year and use the next year to establish the tax expense difference, and adjust the then current rates.[14] For Pacific, the refund obligation through December 31, 1977 for ITC is $51,231,000 and the approximate current rate reduction is $23,346,000 (Table 3, Appendix D). For General, the

[13] This reasoning applied equally to accelerated depreciation.

[14] Annual adjustments may also be implemented when a Commission decision becomes effective after the beginning of the first annual adjustment period. The first annual adjustment will merely be incorporated in any such decision.

comparable figures are $15,649,000 (gross) and $4,771,000 (Table 4, Appendix E).

We are rejecting all the other proposed treatments for varying reasons, principally that they either cause or tend to raise doubts about eligibility, or do not adequately redress the balance between the ratepayers and the utilities.

IMPUTED FLOW-THROUGH OF ACCELERATED DEPRECIATION

In reviewing the record of this proceeding it has come to our attention that certain old vintage plant additions were not previously considered in the ratemaking process. We shall discuss Pacific and General separately.

Pacific

In D.74917 dated November 6, 1968 we imputed flow-through of accelerated tax depreciation for 1967 vintage plant using a 1967 test year. In D.77984 dated November 24, 1970 (test year 1970) the normalization treatment for accelerated depreciation was ordered for Pacific. When this decision was annulled the rates reverted to those set in D.74917 (test year 1967). In D.80347 dated August 8, 1972 rates were increased using 1970 vintage plant additions to determine the flow-through of accelerated depreciation ordered there. The rates set in this final decision were effective until August 17, 1974, the effective date of the rates set in D.83162. The net effect of this history is that no accelerated depreciation for 1968 and 1969 vintage plant additions was ever reflected in Pacific's rates, even though our Supreme Court approved the imputed flow-through of accelerated depreciation.

In Exhibit 32 in A.53587 (and the A.51774 rehearing), this imputation was proposed for the two years in question. We shall adopt this recommendation. Further, we shall continue this imputation through Pacific's test years 1973 in D.83162 and 1974-1975 in D.85287 and shall order here an ongoing reduction in pending A.55492 (test year

1975-1976) for this flow through item. These amounts are as follows:

Flow-Through of 1968 and 1969
Vintage Plant Additions
(Table 5, Appendix F)

	(Dollars in Thousands)
D.83162 (Test Year 1973) 8/17/74 to 1/4/76	$24,158
D.85287 (Test Year 1974-75) 1/5/76 to 12/31/77	19,412
	$43,570
Ongoing reduction (TY 1975-76) A.55492	$ 5,539

SUMMARY OF PACIFIC REFUNDS AND
RATE REDUCTIONS THROUGH DECEMBER 31, 1977

(Dollars in Thousands)

REFUNDS

Accelerated Tax Depreciation (Table 1, Appendix B)	$110,785
ITC (Table 3, Appendix D)	51,231
Flow-Through of 1968 and 1969 Vintage (Table 5, Appendix F)	43,570
TOTAL REFUNDS	$205,586

RATE REDUCTIONS (A. 55492)

Accelerated Tax Depreciation (Table 1, Appendix B)	$ 31,609
ITC (Table 3, Appendix D)	23,346
Flow-Through of 1968 and 1969 Vintage (Table 5, Appendix F)	5,539
TOTAL RATE REDUCTIONS	$ 60,494
TOTAL REFUNDS AND RATE REDUCTIONS	$266,080

General

A similar situation exists for General but it is limited to 1969 vintage plant additions. In D.75873 dated July 1, 1969 we imputed flow-through of accelerated depreciation for 1968 vintage plant using a 1968 test year. In D.79367 dated November 22, 1971 increased rates were ordered using the normalization treatment of accelerated depreciation beginning with 1970 vintage plant additions. Thus, 1969 vintage plant additions were never reflected in General's rates, all of which have been subject to refund since D.79367.

In Exhibit 5-R in A.53935 (and the A.51904 rehearing), this imputation was proposed for 1969. We shall adopt this recommendation and shall continue this imputation from December 12, 1971 (the effective date of D.79367) through test years 1970 (D.79367), 1974 (D.83779), and 1976 (D.87505).

However, in Table 6 of Exhibit 2, General claimed credit for refunds and rate reductions already made as a result of the annulment of D.78851 of Pacific.[15] In D.83778 dated November 26, 1974 we said, on page 41:

> "The refunds already made by General are attributable to the annulment of Decision No. 78851 while the settlement revenue losses to General are attributable to the annulment of that decision and also to the difference between Pacific's rates authorized in Decision No. 80347 and Pacific's annulled rates."

Failure to give General credit for these sums would amount to requiring double refunds. Since this would be inequitable, we are offsetting the losses already incurred

[15] This claim was also made in General's exceptions to the Proposed Report.

against the refunds and rate reductions required of General by this decision.[16]

SUMMARY OF GENERAL NET TOTAL REFUNDS AND RATE REDUCTIONS THROUGH DECEMBER 31, 1977

(Dollars in Thousands)

REFUNDS

Accelerated Tax Depreciation (Table 2, Appendix C)	$34,987
ITC (Table 4, Appendix E)	15,363
Flow-Through of 1969 Vintage (Table 6, Appendix G)	
a. D.79367 (TY 1970) 12/12/71 to 12/20/74	9,244
b. D.83779 (TY 1974) 12/21/74 to 7/17/77	7,245
c. D.87505 (TY 1976) 7/18/77 to 12/31/77	670
TOTAL REFUNDS	$65,440

RATE REDUCTIONS (D.87505)

Accelerated Tax Depreciation (Table 2, Appendix C)	$ 6,571
ITC (Table 4, Appendix E)	4,771
Flow-Through of 1969 Vintage (Table 6, Appendix G)	1,311
TOTAL RATE REDUCTIONS	12,653
TOTAL REFUNDS AND RATE REDUCTIONS	$78,093

[16] In applying the credit, reductions are treated separately for 1971, 1972, and 1973 (from 1/1/73 to 9/22/73 only) and compared to refunds computed for those years, in accordance with the principle used by General in Exhibit 2, Table 6. Reductions in refunds are made first to the imputed flow-through refunds, then any remaining reduction is credited to ITC, and finally and remaining reduction is credited to accelerated tax depreciation. (See Table 7, Appendix H.)

SERVICE

Pacific has depicted a service and employment scenario of horrendous proportions in the event it loses eligibility for accelerated depreciation and ITC, and assuming a back tax payment of $764 million, rate refunds of $73 million and an ongoing rate reduction of $62.6 million. In 1972 and 1973, however, Pacific refunded $176 million together with a rate reduction of $90 million and had no significant employee layoffs, no deterioration in service and no adverse effects on earnings.

Because the eligibility of both companies is unaffected in our judgment, we foresee no meaningful change in the operations and quality of service, number of employees, level of earnings, impairment of financial integrity, or other deleterious consequences as predicted by Pacific. Thus, the companies are put on notice that any deviation from their current service indices, objectives, standards, and our General Order No. 133 shall be monitored and, when appropriate, punished to the fullest extent of the law. For these purposes, we particularly emphasize Pacific's 1976 Service Objective List admitted as Exhibit 43 in its pending A.55492 as exemplary of the service standards expected, together with the ultimate determination, in the same proceeding, of the acceptable level of held primary orders.

MISCELLANEOUS CONTENTIONS

Pacific and General have discussed many other points, some pertinent, some not. We shall briefly discuss due process, actual results of operations, confiscatory rates, retroactive ratemaking, credit for revenues authorized but uncollected, and settlement adjustments.

Pacific relies heavily on the case of *West Ohio Gas Company (No. 2) v Public Utilities Commission* (1935) 294 US 79. There the regulatory agency had, in setting a rate in 1933, chosen to rely exclusively on data from 1929, ignor-

ing available revenue and expense data from 1930 and 1931. The court said this was an unconstitutional procedure. Our situation here is easily distinguishable, as we are taking into account the actual deferred tax reserve and ITC amounts for the past years and computing the functional variables from that actual number. Our Supreme Court in *Los Angeles v PUC* (1975) 15 C 3d 680, has already found this procedure to be proper since the tax expenses and reserves under accelerated depreciation vary abnormally with respect to the other components of a utility's finances. The court said on page 703, "Simply to recognize this fact is not to deny due process."

Further, the actual results of Pacific's operations indicate a financial picture much brighter than depicted by Pacific. It is true that the dividend on common stock has not been increased since 1961, as Pacific alleges, but that is a management decision which is not directly related to its per share earnings or any other indicia of financial progress. In 1961 Pacific had 104 million common shares outstanding while at the end of 1975 it had over 168 million such shares and contemplates over 181 million at the end of 1976. Thus, the total dividends paid now are approximately two-thirds greater than in 1961, to over $202 million in 1975. Further, the earnings per share increased from $1.46 in 1970 to $1.82 in 1975 and $2.06 in 1976, all on an increased number of outstanding shares. There has been an increase in the number of employees, an increase to earned surplus from 1972 to 1975 of the staggering sum of $245 million, and an increase in construction budget from 1971 to 1974 of $225 million. And this was all accomplished while refunding $176 million with an ongoing rate reduction of $90 million per year. In this be confiscation, let there be more of the same. In view of these facts, Pacific's arguments regarding confiscatory rates are untenable and rejected.

Neither do we agree with Pacific's position that the imposition of a penalty for imprudence would constitute improper retroactive and punitive ratemaking since this procedure has already been approved by the Supreme Court (6 C 3d 119). Penalties for imprudence, like penalties for civil or criminal wrong, have nothing to do with rates; they are punishment. But we are not imposing a penalty here; we are determining the proper basis for setting rates.

Pacific has suggested that it is appropriate, in the event the Commission orders a refund in this matter, to deduct from the amount of refund the revenues previously authorized but not collected because it has failed to earn its authorized rate of return. If rate of return has not been earned, the remedy for that, as clearly set forth by the court in 15 C3 680, is to seek rate relief, which both companies have done and are presently doing. Further, this recommendation would guarantee the authorized rate of return. Because it is axiomatic that this Commission does not guarantee the return, but merely provides an opportunity to earn it, the requested credit would be inapposite.

Since our action will not render Pacific ineligible, we need not answer its argument that this would unduly burden interstate commerce, particularly as no evidence on this point was tendered.

The rates to be filed by the utilities pursuant to this order will, of course, reflect settlement payments between utilities. However, we will not authorize any retroactive settlement adjustments associated with refunds resulting from this order.

Refunds in the Form of Stock

It was suggested in the event a refund was ordered that it be accomplished via the issuance of capital stock of Pacific and General. The companies introduced a great deal of material setting forth the problems involved with this idea. The major potential problems are with the Securities & Exchange Commission, the difficulty of issuing minute fractional shares for small refunds to ratepayers, the large

cost of such a program, and the Commission's authority to order such a securities issue. No party supported this concept in its present form. We shall not order it.

Refunds and Reductions

Refunds in the past have been made in direct proportion to the billing of the various customers without regard to class of service. In this case it was suggested that refunds be made only to residential customers on the theory that since business customers include telephone service cost as part of their cost of doing business, they are being paid by the consumer for the cost of the phone service. A refund theoretically would then create a windfall for the business phone customers since no refunds by the business customers would be made to its customers. It can also be argued, however, that the amount of any refund to the business customer would be used to reduce the cost of business for the period in question and thereby would be reflected in lower or stable prices. In our opinion there is no evidence, one way or the other, in this proceeding to support either view.

Another suggestion was to refund to all customers on a per capita basis, meaning that the total amount of the refund would be divided by the total number of customers of the company and the same dollar amount refund would be given to each customer whether residential or business. Since the number of residential customers is much greater than business customers, and as residential revenues approach 50 percent, it is apparent that individual business customers on average pay much greater monthly revenues to the phone companies than the individual residential customers. This proposal, for example, would have the effect of giving the city of Los Angeles, General Motors, and every individual the same amount of refund. In the case of the residential customers, their refunds might well exceed their monthly bills.

Pacific and General will be directed to file proposed refund plans. Approval, disapproval, or modification of the proposed plans will follow by subsequent Commission order.

The ongoing prospective rate reductions ordered herein shall be reflected in rates for all current subscribers by a uniform proportional reduction in the recurring basic exchange primary service rates. To insure that rates for competitive services are not reduced (since those rates are generally priced as nearly as possible at full cost) we are directing that only rates for basic exchange primary service be reduced. With respect to central office centrex service the reductions shall be made on the trunk rate per station.

IRS Ruling Request

The companies have suggested that any proposed action changing the method of normalization now being used should allow the continuance of existing rates, either by putting the rates aside in a trust fund, as suggested by the Supreme Court, or keeping them subject to refund as at present, until such time as a ruling can be rendered by the IRS regarding the retention of eligibility under the method adopted by this Commission for treating the tax expense problems. This is based on the theory that if the IRS disapproves the proposed treatment the present method of accelerated depreciation shall continue in effect, or another proposed method may be submitted for a ruling. But the companies' requests provide no incentives to obtain an expenditious advance IRS ruling, and might lead to further delay in the implementation of the refunds contemplated in this order. Moreover, General's expert witness Nolan indicated that there are some instances where the IRS will not issue an advance ruling, nor does the IRS necessarily advise in advance that it will not issue such a ruling. The supplicant merely waits and hopes. Nolan also said that the more difficult the problem, the more

likely the IRS is to avoid issuing an advance ruling. We have here a case of first impression under the tax laws, and we think an advance ruling within a reasonable time is not probable. Moreover, the opportunities for such action by the utilities have been ample in the past, yet they took no such action. For these reasons we think that their proposals are inappropriate.

EXCEPTIONS TO PROPOSED REPORT

We shall discuss here, where necessary, the exceptions that have not been discussed elsewhere in this opinion.

Pacific

Pacific's exceptions generally fall into two categories:

1. Since D.83162 was issued in August 1974, its earnings have been below the authorized rate of return and it is improper to order refunds and rate reductions in such circumstances. We have already discussed this point elsewhere, and concluded otherwise. There is nothing sufficiently meritorious in Pacific's exceptions in this area that have not been raised, discussed, and disposed of by this Commission, or our Supreme Court.

2. Pacific's eligibility for accelerated tax depreciation and ITC is endangered by the proposed treatment of these benefits.

(a) *Accelerated Tax Depreciation.* Pacific complains of the use of recorded data for historical periods, but in its brief cited the *West Ohio Gas* case (supra) as requiring the recognition of such data. Its position is inconsistent and varies with the direction the wind is blowing. Further, there is no prohibition in proper ratemaking or the IRC sections in question which bar this procedure.

Pacific also complains of the failure to use the pro rata requirements in Treasury Regulation 1.167(*l*)-1(h)(6)(ii). It overlooks the discussion on page 3 of Exhibit 16 sponsored by staff witness John Quinley, where the use of the pro rata percentage of 46.33 is shown. Mr. Quinley explains the offsetting working cash adjustment which produces a combined effect of 50 percent as the proper figure to be used in determining the average deferred tax reserve and its ultimate revenue effect. Footnote 4, Table 1, Exhibit 16, reflects this combined effect, as does Footnote 4, Table 1, Exhibit 10-A (sponsored by Pacific), which uses the identical percentage as its Table 1 is identical to Table 1 of Exhibit 16.

The other exceptions with respect to accelerated depreciation have been either mentioned or explained elsewhere and merit no further discussion.

(b) *Investment Tax Credit.* Pacific cites proposed treasury regulations allegedly relating to its interpretation of our ITC treatment. These proposals in our judgment do not effect the validity of our treatment and have no force or effect, in any event, being mere proposals. We reiterate that our treatment of ITC is akin to an annual ratemaking procedure. We see nothing in law or logic that prohibits this treatment.

General

The thrust of General's exceptions relates to the alleged ineligibility for accelerated depreciation which would occur as a result of the treatment of that subject in the Proposed Report. General alleges that the *total* tax expense must be considered for the same period for which the deferred tax reserve is estimated, and the Proposed Report considers only the reduction in tax expenses. This is not the case, as the reduction in tax expense for years after the test year is used to reduce the *test year tax expense* used in the succeeding year. The effect is to reduce each succeeding year's tax expense, but the entire tax expense is used for the appropriate period. General also alleges that the proposed method is exactly like the old pro forma method, except

for the time period. That is correct, because the failure to consider the deferred tax reserve for the same period as the tax expense is the alleged defect of the old pro forma method regarding eligibility. The Averaged Annual Adjustment remedies this defect by considering the two required items separately for the same period. While the effect is the same as pro forma, we are specifically complying with the existing tax laws by using a proper method to compute the revenue requirement. It must also be noted that this method complies exactly with the method (though not the assumptions) recommended by General and its witnesses.

We have already discussed and decided the other major exception: the double refund effect for revenues authorized but not collected because of Pacific's prior refunds.

There is no retroactive ratemaking involved here since all General's rates since November 22, 1971 have been subject to refund. The fact that ITC was not previously considered does not make it res adjudicata, nor does it prevent this Commission from reflecting its effect where possible. That is what we are doing by this decision.

LA

LA objects to the failure of the Proposed Report to decide the constitutionality of the relevant tax laws under the Tenth Amendment to the U.S. Constitution. We already decided that question in the affirmative in D.83778 and see no reason to go into the matter again.

We have previously discussed, directly or indirectly, all the other matters raised in LA's exceptions.

TURN

TURN filed two exceptions, one relating to its proposed method of determining the amount of refunds (discussed earlier), and the other relating to the effective date of the Proposed Report. We see no need to consider its exceptions.

EPILOGUE

We desire to discuss the wisdom of using the tax laws for the purpose of providing a capital subsidy (in this instance, phantom taxes) from the taxpayers (in this instance, the ratepayers) to a special interest group (in this instance, state-regulated utilities). This occurs because every dollar of taxes that the utilities pay is obtained in rates from the ratepayer, even when the utilities can defer, and perhaps never pay the taxes collected in rates. The regulators must essentially order two dollars to be paid to the utility by the ratepayer for each dollar in taxes avowedly to be paid by the utility. This seems to us to be a wasteful use of resources as well as a legally sanctioned subsidy to the utility from the ratepayer without the latter's consent. The money is not being contributed by investors in the usual manner, but is being contributed in the form of rates by the ratepayer on a two-for-one basis and not on a one-for-one basis, as it the case for traditional investment capital. The funds are being obtained from the ratepayers under the guise of taxes, while Congress has decreed that the money so collected as taxes need not be used as taxes by the utilities, but may be used by the utilities for whatever purposes they desire. There is no restriction on the use of these funds in the tax laws. The taxes collected, but not paid, in essence amount to a direct capital subsidy which the utilities may use as unrestricted capital. Nothing is paid to the ratepayers for this investment use of the ratepayers' money as would be paid to traditional investors. Thus, this is free capital, and this is occurring in a free enterprise system which traditionally rewards venture and investment capital!! Here, the converse is true. The ratepayers are actually being penalized instead of being compensated for this subsidy. Their money is being involuntarily contributed on a two-for-one basis, and no return is forthcoming on any basis. We think this is grossly unfair and should be more forcefully presented by the utilities, by the regulatory agencies, and by con-

sumer organizations. Congress has created a situation where in California both the utilities and the ratepayers feel they are being whipsawed by these tax laws and the actions of this Commission in attempting to be fair to all sides. This Commission believes that it has a legal duty to balance the interests of the utilities and the ratepayers and is attempting to do so, but finds itself more frequently hamstrung by the actions of Congress where it appears that the interests of the utility ratepayers are not adequately considered, for whatever reason.

What this Commission proposes and strongly supports, in lieu of this hidden subsidy and no-cost capital contribution to the utilities by the ratepayers (we mean at no cost to the utilities), is the elimination of the income tax upon regulated utilities to be replaced with a gross receipts tax (or, for energy and water utilities, a per unit of consumption tax), as a surcharge to all billings paid by the ratepayers, to be collected by the utilities and paid directly to the IRS. This surcharge would be indicated as such on the utility bills and would not be included in the utility cost-of-service. It could easily be structured to provide revenues to the treasury equivalent to that now being *paid* as income taxes by the utilities. It would eliminate the ratepayers' involuntary and hidden subsidy to the utilities because what they pay in gross receipts tax is what the IRS gets on a dollar-for-dollar basis. If the utilities desire to obtain funds from the ratepayers for the purpose of expansion and investment, let it be done forthrightly by direct subsidy so the ratepayers will have knowledge and the opportunity for input. Let the ratepayers share in whatever benefits might accrue to the utility as the result of any such investment by the ratepayers. We see no reason why the ratepayers, in their role of capital investors, should not share in the fruits of their investment. We believe the tax laws are not the proper medium for the creation of involuntary investment capital. Tax law gimmickry should not tilt or distort the balance necessary between state-regulated utilities and ratepayers.

The gross receipts tax would simplify the job of Congress in levying taxes and simplify the job of the regulatory agencies in setting rates, while preserving the rights of both the utility and the ratepayers. It would create faster rate relief on the part of regulatory agencies and maintain the utilities on a solid financial basis, instead of requiring everyone involved in setting rates to go through a series of contortions and distortions to attempt to comply with or legally avoid the effect of the existing tax laws and the concommitant uncertainty and delays.

FINDINGS

1. Pacific and General were imprudent in failing to select accelerated depreciation when that option was available under the federal tax laws. This imprudence denied the companies the option to elect flow-through accounting for ITC and accelerated depreciation purposes.

2. Flow-through of the tax benefits accruing under accelerated depreciation and ITC is the best method of handling these benefits for the purpose of balancing the interest of the ratepayers and the companies for ratemaking purposes.

3. Pacific and General are ineligible to elect flow-through accounting for accelerated depreciation and ITC for ratemaking purposes pursuant to IRC Section 167, et seq. and Treasury Regulation 1.167, et seq. Normalization accounting is the most appropriate method available to Pacific and General. Under the normalization method we are adopting for ratemaking purposes, tax depreciation expense for ratemaking purposes will be computed on a straight-line basis while federal taxes will be computed on an accelerated depreciation basis. The difference between the two tax computations will be accounted for in a deferred tax reserve. The average sum of the test year deferred tax reserve and the deferred tax reserve for the

three next subsequent years shall be deducted from rate base in the test year. As a result of each of the deductions from rate base federal tax expense will be recomputed on the same basis in the test year for the test year and the three corresponding subsequent years, thus matching the estimated tax deferral amount for each period with the estimated federal tax expense for the same period. This method complies with Treasury Regulation 1.167(*l*)-(1)(h)(6) and is normalization accounting.

4. For ITC we shall make an adjustment prior to the end of each calendar year (or as soon thereafter as possible) for the rates to be set beginning January 1 of the next calendar year taking into account at that time the growth in the amount of ITC estimated for the next immediate future calendar year as compared to the last test year (or last preceding year), and recomputing federal tax expense and gross revenue requirements based on that new estimate for each year between rate cases. This method complies with the requirements of ratable (service life) flow-through selected by the utilities under IRC Section 46.

5. The methods described in Findings 3 and 4 are an attempt to more accurately reflect in rates the abnormal growth in these reserves compared to the other components of cost-of-service used in computing rates.

6. The methods adopted in this order as described in Findings 3 and 4 comply with the mandate of the California Supreme Court set forth in *City of Los Angeles v Public Utilities Commission* (1975) 15 C 3d 680.

7. The methods described in Findings 3 and 4 fairly balance the interests of the ratepayers and the utilities and avoid harsh results to either as a result of the tax benefits accruing under accelerated depreciation and ITC.

8. The amount to be refunded by Pacific to its ratepayers under the method described in Finding 3 for accelerated depreciation is $110,785,000, including interest at 7 per-

cent per annum from the date of the respective orders entered from which refunds are being required, as set forth in Table 1. The current rate reduction under this method is $31,609,000.

9. The gross amount to be refunded by General to its ratepayers under the method described in Finding 3 for accelerated depreciation is $40,230,000, including interest at 7 percent per annum from the date of the respective orders entered from which refunds are being required, as set forth in Tables 2 and 7. The current rate reduction under this method is $6,571,000.

10. The amount to be refunded by Pacific to its ratepayers under the method described in Finding 4 for ITC is $51,231,000, including interest at 7 percent per annum from the date of the respective orders entered from which refunds are being required, as set forth in Table 3. The current rate reduction under this method is $23,346,000.

11. The gross amount to be refunded by General to its ratepayers under the method described in Finding 4 for ITC is $15,649,000, including interest at 7 percent per annum from the date of the respective orders entered from which refunds are being required, as set forth in Table 4. The current rate reduction under this method is $4,771,000.

12. The maintenance of eligibility under the federal tax laws to allow Pacific and General to use accelerated depreciation and ITC is beneficial to both the ratepayers and the utilities and is an important goal of this Commission in this decision.

13. It is reasonable to order a uniform proportional reduction in the recurring basic exchange primary service rates. With respect to central office centrex service it is reasonable to make the reductions on the trunk rate per station.

14. It is reasonable to impute flow-through of 1968 and 1969 vintage plant additions for Pacific and 1969 vintage

plant additions for General, as the Supreme Court has previously approved this procedure in *San Francisco v. PUC* (1971) 6 C 3 119, and accelerated depreciation of these vintages has never been reflected in rates.

15. A gross receipts tax surcharge would abolish the "two-for-one" collection of income taxes from the ratepayers in rate setting for utilities and would allow lower utility rates since the gross receipts tax would allow a dollar-for-dollar collection of taxes *paid* by the utilities to the federal government.

16. As long as plant investment of the utility continues to expand, the deferred tax reserve is actually a tax saving and not a tax deferral.

17. It is unfair and unreasonable to use the tax laws to create investment dollars flowing from the ratepayers to the utilities on which the ratepayers do not receive any return.

18. The gross receipts tax surcharge would eliminate the involuntary capital contribution incurred by the ratepayers and would abolish the windfall to the utilities by allowing them to collect taxes from the ratepayers which they may never have to pay.

19. The investment tax credit is a tax saving and not a tax deferral.

20. A gross receipts tax surcharge will prevent the distortion of the tax laws to create subsidies from the ratepayers to the utilities in the setting of rates.

21. In computing the refunds and rate reductions computed herein, this Commission has used recorded figures, where available, for the periods in question.

22. The reduction and refunds of rates authorized by this decision are justified and reasonable, and the present rates as they differ from those prescribed therein, are for the future unjust and unreasonable.

23. No revenue adjustments for settlements by Pacific and General with interconnecting carriers will be allowed for the refund period.

24. The amount to be refunded by Pacific to its ratepayers pursuant to Finding 14 is $43,570,000, including interest at 7 percent per annum from the date of the respective order entered from which refunds are being required, as set forth in Appendix F. The current rate reduction under this method is $5,539,000.

25. Because of revenues authorized, but not collected, General is entitled to credit for certain sums refunded and lower rates set due to *San Francisco v PUC* (1971) 6 C 3 119 and D.78851 of Pacific. It is reasonable to offset these amounts against the other refunds required herein, on an annual basis only, first reducing the imputed flow-through of accelerated depreciation under Finding 14, then the ITC refund, and lastly, the accelerated tax depreciation refund.

26. The net amount to be refunded by General to its taxpayers, pursuant to Findings 14 and 25, is $17,159,000, including interest at 7 percent per annum from the date of the respective orders entered from which refunds are being required, as set forth in Appendix G. The current rate reduction under this method is $1,311,000.

27. As a result of Finding 25, the refunds due from General, pursuant to Findings 9 and 11, are reduced to the net sums of $34,453,000 (Finding 9) and $13,828,000 (Finding 11).

28. The total net refunds due from Pacific and General, and the total current and/or ongoing rate reductions required respectively, are summarized in the tables on page 32 (for Pacific) and page 34 (for General).

CONCLUSIONS

1. The methods described in Findings 3 and 4 maintain the eligibility of the utilities to use accelerated depreciation

and ITC and comply with the requirements of the Internal Revenue Code relating to Pacific and General.

2. This Commission does not guarantee the utility the rate of return authorized in rate proceedings, but merely provides an opportunity to earn that return.

3. The method described in Finding 3 for accelerated depreciation for Pacific and General is a normalization method of accounting.

4. The method contained in Finding 4 for ITC complies with the ratable (service life) flow-through option of ITC under IRC Section 46.

5. The imputation of flow-through of the accelerated tax depreciation benefits for 1968 and 1969 vintage plant additions for Pacific and 1969 vintage plant additions for General is a proper ratemaking procedure and does not affect eligibility under the TRA of 1969.

6. The rates being set herein are not confiscatory.

7. The offset allowed General due to the revenues authorized, but not realized, is a proper ratemaking procedure.

8. There is no retroactive ratemaking ordered in this decision.

Order

IT IS ORDERED that:

1. The Pacific Telephone and Telegraph Company shall refund the sum of $205,586,000 (computed as of December 31, 1977), being the total of the amounts due under the recomputation of accelerated depreciation with normalization, investment tax credit on the service life flow-through basis, and accelerated depreciation for 1968 and 1969 vintage plant addition on a flow-through basis, as determined herein pursuant to Findings 3, 4, and 14. This

amount includes interest at the rate of 7 percent per year from the respective effective dates of the rates being refunded.

2. General Telephone Company of California shall refund the sum of $65,440,000 (computed as of December 31, 1977), being the net total of the amounts due under the recomputation of accelerated depreciation with normalization, investment tax credit on the service life flow-through basis, accelerated depreciation for 1969 vintage plant additions on a flow-through basis, and certain offsets thereto, as determined herein pursuant to Findings 3, 4, 14, and 25. This amount includes interest at the rate of 7 percent per year from the respective effective dates of the rates being refunded.

3. The Pacific Telephone and Telegraph Company and General Telephone Company of California shall prepare and file refund plans for all current (at the time of filing of the plan) subscribers. This plan shall be filed within thirty days after the effective date of this order. This plan must be approved by an order or resolution of the Commission.

4. The methods described in Findings 3, 4, and 14 shall be applied to all future rates of The Pacific Telephone and Telegraph and General Telephone Company of California.

5. The filings required for the continuous surveillance of earned rate of return as previously ordered in D.83540 and D.83778 are no longer required.

6. The Pacific Telephone and Telegraph Company shall reduce current rates by the sum of $60,494,000 (computed as of December 31, 1977), being the total of the reductions due under the recomputation of accelerated depreciation with normalization, investment tax credit on the service life flow-through basis, and accelerated depreciation for 1968 and 1969 vintage plant additions on a flow-through

basis, as determined herein pursuant to Findings 3, 4, and 14.

7. General Telephone Company of California shall reduce current rates by the sum of $12,653,000 (computed as of December 31, 1977), being the net total of the reductions due under the recomputation of accelerated depreciation with normalization, investment tax credit on the service life flow-through basis, accelerated depreciation for 1969 vintage plant additions on a flow-through basis, and certain offsets thereto, as determined pursuant to Findings 3, 4, 14, and 25.

8. The Pacific Telephone and Telegraph Company and General Telephone Company of California shall prepare and file tariffs reflecting such reductions on a uniform proportional basis on recurring basic exchange primary service rates, and with respect to central office centrex service the reductions shall be made on the trunk rate per station. Such tariffs shall be filed within thirty days after the effective date of this order and shall not become effective until approved by order or resolution of this Commission.

9. Pacific and General shall not recompute intercompany EAS or other settlement amounts between themselves or with other independent companies as a result of the refunds or rate adjustments ordered herein except for busniess done on or after the effective date of this order.

10. In the event the refund plans and tariffs required to be filed by this order are effective after December 31, 1977, the amounts shown in Ordering Paragraphs 1, 2, 6, and 7 shall be recomputed to the appropriate effective date of the refund plan or tariff filing, with interest as computed in Ordering Paragraphs 1 and 2.

The effective date of this order shall be twenty days after the date hereof.

Dated at San Francisco, California, this 13th day of September, 1977.

ROBERT BATINOVICH
President

RICHARD D. GRAVELLE

CLAIRE T. DEDRICK
Commissioners

I will file a written dissent.
/s/ VERNON L. STURGEON
Commissioner

I will file a dissent.
/s/ WILLIAM SYMONS, JR.
Commissioner

I will file a concurrence.
/s/ RICHARD D. GRAVELLE

CERTIFIED AS A TRUE COPY
OF THE ORIGINAL

/s/ H. L. FARMER

Assistant Executive Director
Public Utilities Commission
State of California

Appendix A

List of Appearances

Applicants: Robert M. Ralls and *Robert Dalenberg,* Attorneys at Law, for The Pacific Telephone and Telegraph Company; *John Robert Jones, A. M. Hart,* and H. Ralph Snyder, Jr., Attorneys at Law, for General Telephone Company of California.

Interested Parties: Thomas M. O'Connor, City Attorney, and *Robert Laughead,* for City and County of San Francisco; Robert W. Russell and *Manuel Kroman,* for Department of Public Utilities & Transportation, City of Los Angeles; *George R. Gilmour,* Attorney at Law, for TURN; *James F. Crafts, Jr.,* Attorney at Law, and *Del Williams,* for Continental Telephone Company; *Louis Possner,* for City of Long Beach; John W. Witt, City Attorney, by *William S. Shaffran,* Deputy City Attorney, for City of San Diego; *Alexander Googooian,* City Attorney, for City of Bellflower; Burt Pines, City Attorney, by *Leonard L. Snaider,* Deputy City Attorney, for City of Los Angeles; *Jack Krinsky,* for Ad Visor, Inc.; *Dina G. Beaumont,* for Communications Workers of America; *Thelma Garcia,* for Pacific Telephone Women Employees for Affirmative Action; *Joseph J. Salazar* for Los Padrinos, Inc.; *William M. Bennett,* attorney at law, for Consumers Arise Now, and himself; *Diamantes P. Katsikaris,* for Independent Taxpayers Union of California, Inc.; *Timothy J. Sampson,* for Citizens Action League; and John Mack, by *Ballard W. Brooks,* for Los Angeles Urban League.

Commission Staff: *Timothy Treacy,* Attorney at Law, *J. D. Quinley,* and *K. K. Chew.*

Appendix B
Page 1 of 2

Table 1

The Pacific Telephone and Telegraph Company Intrastate Operations

Computations of Refunds and Ongoing Revenue Reduction Due to Newly Adopted Treatment of Tax Expense Related to Liberalized Tax Depreciation

Test Year	Depreciation Differential [1]	Federal Tax Effect [1]	Average Reserve for Deferred Taxes [1]	Net Revenue Reduction: Normalization [2]	Net Revenue Reduction: Average Annual Adjustment [3]	Net Revenue Reduction: Additional Net Reduction [4]	Federal Income Tax Reduction [5]	Other Gross Revenue Effects [6]	Gross Revenue Reduction Over Normalization [7]	Refunds by Decision and Year's Rates Effective: Year	Refunds by Decision and Year's Rates Effective: Refund [8]
	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)	(K)
				(DOLLARS IN THOUSANDS)							
1973	$148,963	$ 71,502	$136,787	$12,106	$24,418	$12,312	$11,364	$480	$24,156	1974	$ 11,501 [9]
										1975	30,623 [9]
										1976	356 [9]
1974-5	207,825 [12]	99,756	267,925 [12]	23,711	38,687	14,976	13,823	644	29,443	1976	33,836 [10]
										1977	34,469 [10]
									Total Refunds Through December 31,	1977	$110,785
1975-6	235,807 [12]	113,187	374,396 [12]	33,134	49,212	16,078	14,840	691	31,609	1978	31,609 [11]
									Annual Ongoing Reduction in Excess of Normalization		$ 31,609

TABLE 1

NOTES

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY

INTRASTATE OPERATIONS

[1] Exhibit 10-A, Table 1, Columns (A) and (D). Tax at 48% of Column (A).

[2] Exhibit 10-A, Table 2, Normalization ÷ NTG (1.962 for 1973 and 1.966 for other test periods).

[3] Exhibit 16-A, Table 2-A, Column (B) ÷ NTG.

[4] Column (E) minus Column (D).

[5] Column (F) × .92307 [(F) × .48/1 — .48].

[6] Effects of state income tax and uncollectibles (.039 × Col. (F) for T.Y. 1973 and .043 × Col. (F) for T.Y. 1974-75 and 1975-76).

[7] (F) + (G) + (H).

[8] Col. (I) adjusted as per Exhibit 34, page 4 and Exhibit 41, Interest added at the rate of 7% per year for 1974-77.

[9] D.83162 rates effective 8-17-74 to 1-4-76.

[10] D.85287 rates effective 1-5-76.

[11] A.55492 test year data adjusted to most recent estimates.

[12] Average of two calendar years.

Appendix C
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TABLE 2

GENERAL TELEPHONE COMPANY OF CALIFORNIA INTRASTATE OPERATIONS

COMPUTATIONS OF REFUNDS AND ONGOING REVENUE REDUCTION DUE TO NEWLY ADOPTED TREATMENT OF TAX EXPENSE RELATED TO LIBERALIZED TAX DEPRECIATION

				Net Revenue Reduction					Refunds by Decision and Year's Rates Effective	
Test Year	Depreciation Differential [1]	Federal Tax Effect [1]	Average Reserve for Deferred Taxes [1]	Normalization [2]	Average Annual Adjustment [3]	Additional Net Reduction [4]	Federal Income Tax Reduction [5]	Other Gross Revenue Effects [6]	Gross Revenue Reduction Over Normalization [7]	Year	Refund [8]
	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)	(K)
				(DOLLARS IN THOUSANDS)							
1970	$ 3,565	$ 1,711	$ 856	$ 71	$ 1,621	$1,550	$1,431	$255	$3,236	—	—
										1971	$ — [9,12]
										1972	— [9,12]
										1973	5,398[9]
										1974	5,203[9]
1974	45,881	22,023	65,669	5,812	8,797	2,985	2,755	594	6,334	1974	230[10]
										1975	7,986[10]
										1976	8,052[10]
										1977	4,255[10]
1976	47,519	22,809	110,507	9,780	12,865	3,085	2,848	638	6,571	1977	3,329[11]
						Total Refunds Through December 31,				1977	$34,453
										1978	6,571[11]
						Annual Ongoing Reduction in Excess of Normalization					$ 6,571

TABLE 2

NOTES

GENERAL TELEPHONE COMPANY OF CALIFORNIA

INTRASTATE OPERATIONS

[1] Exhibit 2, Table 1, Columns (A), (B), and (D).

[2] Exhibit 2, Table 2, Normalization ÷ NTG (2.087 for T.Y. 1970 and 2.113 for T.Y. 1974 and 1976).

[3] Exhibit 6-A, Table 2-A, Column (B) ÷ NTG.

[4] Column (E) minus Column (D).

[5] Column (F) × .92037 [(F) × .48/1 — .48}.

[6] Effects of state income tax and uncollectibles (.1645 × Col. (F) for T.Y. 1970, .1990 × Col. (F) for T.Y. 1974 and .20695 × Col. (F) for T.Y. 1976).

[7] (F) + (G) + (H).

[8] Column (I) adjusted as per Exhibit 25, Table A-A-2. Interest added at the rate of 7% per year for 1971-77.

[9] D.79367 rates effective 12-12-71 to 12-20-74.

[10] D.83779 rates effective 12-21-74 to 7-17-77.

[11] D.87505 rates effective 7-18-77. Test year data adjusted to most recent estimates.

[12] Adjustments for revenues not collected are shown on Table 7.

Appendix D

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TABLE 3

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY INTRASTATE OPERATIONS

COMPUTATION OF REFUNDS AND 1978 REVENUE REDUCTION DUE TO NEWLY ADOPTED TREATMENT OF TAX EXPENSE RELATED TO INVESTMENT TAX CREDIT

Test Year (Adjustment Year)	Net Revenue Reduction				Federal Income Tax Reduction [6]	Other Gross Revenue Effects [6]	Gross Revenue Reduction Over Service Life Flow-Through [7]	Refunds by Decision and Year's Rates Effective	
	Investment Credit Realized [1]	Service Life Flow-Through [2]	Annual Adjustment [3]	Additional Net Reduction [4]				Year	Refund [8]
	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)
				(DOLLARS IN THOUSANDS)					
1973	$22,028	$ 3,249	$ 3,249	$ —	$ —	$ —	$ —	—	$ —
(1974)	24,901	3,249	4,805	1,556	1,437	60	3,053	1974	1,411[9]
(1975)	62,157	3,249	9,025	5,776	5,332	225	11,333	1975	13,302[9]
(1976)	65,983	3,249	13,315	10,066	9,291	392	19,749	1976	245[9]
1974-75	43,529[12]	6,915[12]	6,915[12]	—	—	—	—		
(1976)	65,983	6,915	13,315	6,400	5,907	275	12,582	1976	13,611[10]
(1977)	71,965	6,915	17,994	11,079	10,226	476	21,781	1977	22,662[10]
							Total Refunds Through December 31,	1977	$51,231
1975-76	64,070[12]	11,170[12]	11,170[12]	—	—	—	—		
(1977)	71,965	11,170[12]	17,994[12]	6,824	6,299	293	13,416	1978	23,346[11]
(1978)	77,683	11,170	23,045	11,875	10,960	511	23,346		
							Year 1978 Reduction in Excess of Service Life Flow-Through		$23,346

TABLE 3

NOTES

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY

INTRASTATE OPERATIONS

[1] Exhibit 10-A, Table 3, Column (A).

[2] Exhibit 10-A, Table 3, Column (D).

[3] Exhibit 10-A, Table 3, Column (D) in adjustment year.

[4] Column (C) minus Column (B). Note duplication of amounts for 1974, 1975, and 1976.

[5] Column (D) × .92307 [(D × .48/1 — .48].

[6] Effects of state income tax and uncollectibles (.039 × Col. (D) for T.Y. 1973 and .043 × Col .(D) for T.Y. 1974-75 and 1975-76).

[7] Columns (D) + (E) + (F).

[8] Column (G) adjusted as per Exhibit 40, Computation Method 2. Interest added at the rate of 7% per year for 1974-77.

[9] D.83162 rates effective 8-17-74 to 1-4-76.

[10] D.85287 rates effective 1-5-76. One-half 1977 included.

[11] A.55492 test year data adjusted to most recent estimates. 1978 reduction, Column (G).

[12] Average of two calendar years.

[13] Adjusted as 10/4 times amounts shown in Exhibit 10-A, Table 3 for 1977 in order to approximately reflect the 10% Investment Credit available under the Tax Reform Act of 1976.

Appendix E
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TABLE 4

GENERAL TELEPHONE COMPANY OF CALIFORNIA INTRASTATE OPERATIONS
COMPUTATION OF REFUNDS AND 1978 REVENUE REDUCTION DUE TO NEWLY ADOPTED TREATMENT OF TAX EXPENSE RELATED TO INVESTMENT TAX CREDIT

Test Year (Adjustment Year)	Investment Credit Realized [1]	Net Revenue Reduction: Service Life Flow-Through [2]	Net Revenue Reduction: Annual Adjustment [3]	Net Revenue Reduction: Additional Net Reduction [4]	Federal Income Tax Reduction [5]	Other Gross Revenue Effects [6]	Gross Revenue Reduction Over Service Life Flow-Through [7]	Refunds by Decision and Year's Rates Effective: Year	Refunds by Decision and Year's Rates Effective: Refund [8]
	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)
				(DOLLARS IN THOUSANDS)					
1970	—	—	—	—	—	—	—	—	—
(1971)	$ 2,802	$ —	$ 200	$ 200	$ 185	$ 33	$ 418	1971	$ —[9,13]
(1972)	5,119	—	420	420	388	69	877	1972	—[9,13]
(1973)	4,477	—	718	718	663	118	1,499	1973	1,520[9,13]
(1974)	5,006	—	1,052	1,052	971	173	2,196	1974	2,664[9]
1974	5,006	1,052	1,052	—	—	—	—	—	—
(1975)	9,845	1,052	1,708	656	605	131	1,392	1975	1,632[10]
(1976)	12,267	1,052	2,526	1,474	1,360	294	3,128	1976	3,428[10]
(1977)	20,093	1,052	3,866	2,814	2,597	561	5,972	1977	3,267[10]
1976	12,267	2,526	2,526	—	—	—	—	—	—
(1977)	20,093[12]	2,526[12]	3,866[12]	1,340	1,237	277	2,854	—	1,317[11]
						Total Refunds Through December 31,		1977	$13,828
(1978)	13,495	2,526	4,766	2,240	2,067	464	4,771	1978	4,771[11]
						Year 1978 Reduction in Excess of Service Life Flow-Through			4,771

TABLE 4

NOTES

GENERAL TELEPHONE COMPANY OF CALIFORNIA

INTRASTATE OPERATIONS

[1] Exhibit 2, Table 3, Column (A). Note duplication of amounts for 1974 and 1976.

[2] Exhibit 6, Table 3, Column (D).

[3] Exhibit 6, Table 3, Column (D) in adjustment year.

[4] Column (C) minus Column (B).

[5] Column (D) × .92307 [(D) × .48/1 — .48].

[6] Effects of state income tax and uncollectibles. (.1645 × Col. (D) for T.Y. 1970 and .1990 × Col. (D) for T.Y. 1974 and .20695 × Col. D for T.Y. 1976).

[7] Columns (D) + (E) + (F).

[8] Column (G) adjusted as per Exhibit 25, Table 8-A. Interest added at the rate of 7% per year for 1971-77.

[9] D.79367 rates effective 12-12-71 to 12-20-74.

[10] D.83779 rates effective 12-21-74 to 7-17-77.

[11] D.87505 rates effective 7-18-77. Test year data adjusted to most recent estimates.

[12] Adjusted as 10/4 times amounts shown in Exhibit 6, Table 3 for 1977 in order to approximately reflect the 10% investment credit under the Tax Reform Act of 1976.

[13] Adjustments for revenues not collected are shown on Table 7.

Appendix F

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TABLE 5

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY INTRASTATE OPERATIONS

COMPUTATIONS OF REFUNDS AND ONGOING REVENUE REDUCTION DUE TO IMPUTED FLOW-THROUGH OF ACCELERATED TAX DEPRECIATION FOR VINTAGE YEAR 1968 AND 1969 PLANT ADDITIONS

Test Year	Federal Tax Effect of Accelerated Tax Depreciation—First Year		Additional Net Revenue Reduction Vintage Year 1968-1969 Additions [3]	Federal Income Tax Reduction [4]	Other Gross Revenue Effects [5]	Additional Gross Revenue Reduction [6]	Refunds by Decision and Year's Rates Effective Year	Refund [7]
	1970 [1]	1968 [2]						
	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)
			(DOLLARS IN THOUSANDS)					
1973	$43,131	$50,132	$7,001	$6,462	$273	$13,736	1974	$ 6,540 [9]
							1975	17,415 [10]
							1976	203 [11]
1974-5	57,103	61,359	4,256	3,929	183	8,368	1976	9,616 [12]
							1977	9,796 [13]
							Total Refunds Through December 31, 1977	$43,570
1975-6	65,782	68,599	2,817	2,600	122	5,539	1978	5,539 [13]
							Annual Ongoing Reduction	$ 5,539

TABLE 5

NOTES

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY

INTRASTATE OPERATIONS

[1] Exhibit 32 in A.53587, Table II, Column (a), Tax Depreciation × 48%. For fiscal years, use average of calendar years.

[2] Exhibit 32 in A.53587, Table II-A, Column (a), Tax Depreciation × 48%. For fiscal years, use average of calendar years.

[3] Column (B) minus Column (A).

[4] Column (C) × .92307 ((C) × .48/1 — .48).

[5] Effects of state income tax and uncollectibles (.039 × Col. (C) for T.Y. 1973 and .043 × Col. (C) for T.Y. 1974-75 and 1975-76).

[6] (C) + (D) + (E).

[7] Col. (I) adjusted as per Exhibit 34, page 4 and Exhibit 41. Interest added at the rate of 7% per year for 1974-77.

[8] D.83162 rates effective 8-17-74 to 1-4-76.

[9] D.85287 rates effective 1-5-76.

[10] A.55492 test year data adjusted to most recent estimates.

[11] Average of two calendar years.

Appendix G
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TABLE 6

GENERAL TELEPHONE COMPANY OF CALIFORNIA INTRASTATE OPERATIONS

COMPUTATIONS OF REFUNDS AND ONGOING REVENUE REDUCTION DUE TO IMPUTED FLOW-THROUGH OF ACCELERATED TAX DEPRECIATION FOR VINTAGE YEAR 1969 PLANT ADDITIONS

Test Year	Federal Tax Effect of Accelerated Tax Depreciation—First Year		Additional Net Revenue Reduction Vintage Year 1969 Additions [3]	Federal Income Tax		Other Gross Revenue Effects [5]	Additional Gross Revenue	Refunds by Decision and Year's Rates Effective		
	1970 [1]	1969 [2]	Reduction [4]	Reduction [4]			Reduction [6]	Year	Refund [7]	
	(A)	(B)	(C)	(D)		(E)	(F)	(G)	(H)	
			(DOLLARS IN THOUSANDS)							
1970	$ 1,811	$ 3,963	$2,152	$1,986		$353	$4,491	—	—	
								1971	[8, 11]	
								1972	[8, 11]	
								1973	$ 2,015 [8, 11]	
1974	11,001	12,055	1,054	973		209	2,236	1974	7,229 [9]	
								1974	81 [9]	
								1975	2,819 [9]	
								1976	2,843 [9]	
								1977	1,502 [9]	
1976	13,789	14,410	621	573		128	1,322	1977	670 [10]	
				Total Refunds Through December 31,				1977	$17,159	
								1978	1,311 [10]	
								Annual Ongoing Reduction	$ 1,311	

TABLE 6

NOTES

GENERAL TELEPHONE COMPANY OF CALIFORNIA

INTRASTATE OPERATIONS

[1] Exhibit 5-R in A.53935 and A.51904 Rehearing, Table I, Column (a) Tax Depreciation × 48% × intrastate factors of .891 for T.Y. 1970, .873 for T.Y. 1974, and .855 for T.Y. 1976.

[2] Exhibit 5-R, Table I-A, Column (a), Tax Depreciation × 48% × intrastate factors as in Footnote 1, above.

[3] Column (B) minus Column (A).

[4] Column (C) × .92307 ((C) × .48/1 — .48).

[5] Effects of state income tax and uncollectibles (.1645 × Col. (C) for T. Y. 1970, .1990 × Col. (C) for T.Y. 1974, and .20695 × Col. (C) for T.Y. 1976).

[6] (C) + (D) + (E).

[7] Column (H) adjusted as per Exhibit 25, Table A-A-2. Interest added at the rate of 7% per year for 1971-77.

[8] D.79367 rates effective 12-12-71 to 12-20-74.

[9] D.83779 rates effective 12-21-74 to 7-17-77.

[10] D.87505 rates effective 7-18-77. Test year data adjusted to most recent estimates.

[11] Adjustments for revenues not collected are shown on Table 7.

Appendix H

TABLE 7

GENERAL TELEPHONE COMPANY OF CALIFORNIA
INTRASTATE OPERATIONS

ADJUSTMENTS TO TABLES 2, 4, AND 6 FOR REVENUES NOT COLLECTED

Line No.	Item	Gross Revenue Reductions 12-12-71 to 12-31-71	1972	1-1-73 to 9-22-73
		(A)	(B)	(C)
		(Dollars in Thousands)		
1	Total Revenues Not Collected [1]	$ 846	$12,601	$4,372
2	Line 1 Adjusted to 12-31-77 Refund Levels [2]	1,313	18,889	5,963
	Refund Offset by Line 2			
3	Imputed Flow-Through	377	7,616	5,476
4	Investment Tax Credit	35	1,299	487
5	Liberalized Tax Depreciation	291	5,486	—
6	Remaining Revenues Not Collected [3]	393	2,994	—

[1] Exhibit 2, Table 6, line 15 (adjusted for D.83778 refunds).

[2] Adjusted by including interest to match refund amounts.

[3] Line 2, less lines 4, 5, and 6, divided by interest factor.

COMMISSIONER RICHARD D. GRAVELLE, CONCURRING.

COMMISSIONER CLAIRE T. DEDRICK, CONCURRING.

We concur.

Today's decision, while attributed to this Commission, is not really ours. We are merely the instrument of delivery. This decision was spawned by the Bell System; nurtured by Congress; brought through adolescence by the efforts of our staff, the cities of San Francisco, Los Angeles, San Diego, and TURN; shaped into maturity by the California Supreme Court; and finally left to us for mere refinement. The entity most responsible for the result of the order as it stands is the Court, which clearly mandated us to achieve a balance between utility and ratepayer which we have finally done. We have also protected eligibility by carefully remaining within the confines of the tax laws and regulations. No one, however, should be confused on the latter point. The *ultimate* verdict on the validity of this decision will have to be made in the United States Supreme Court and the sooner that is accomplished the better off all participants will be.

San Francisco, California
September 13, 1977

/s/ RICHARD D. GRAVELLE
RICHARD D. GRAVELLE, Commissioner

/s/ CLAIRE T. DEDRICK, Commissioner
CLAIRE T. DEDRICK, Commissioner

PACIFIC TELEPHONE & TELEGRAPH COMPANY

GENERAL TELEPHONE COMPANY OF CALIFORNIA

Re: Accelerated Depreciation and Investment Tax Credit

COMMISSIONER WILLIAM SYMONS, JR., Dissenting

California stands to lose at least a billion dollars, with nothing to gain, as the Public Utilities Commission majority again plays brinkmanship with the United States Government. There is no need to recklessly risk eligibility for such enormous sums in federal tax deferrals and federal tax forgiveness.

Congress enacted the federal tax laws, and in order to qualify for specific federal tax benefits, it is realistic to expect that the intentions of Congress be respected. Eligibility under the federal tax laws makes it possible for the communication companies in California to use accelerated depreciation and to receive investment tax credit. To have the federal government forego the collection of these taxes is most beneficial to both the utilities and the ratepayers. To risk these tax benefits so needlessly is bad regulatory administration. Loss of eligibility through 1976 as a consequence of California Public Utilities Commission action means that Pacific Telephone will have to pay taxing authorities in Washington, D.C., retroactive tax bills of $764 million. General Telephone will have to pay $223 million. Loss of eligibility into the future will cost our communication system and ratepayers additional hundreds of millions of dollars in taxes.

I cannot support a decision which fails to take the opportunity to resolve the "eligibility" issue before the Commisson decision is finalized and "set in concrete". Assurance on the issue of eligibility is proceduraly feasible if we were to follow the recommendation of the Administrative Law Judge in this case. The order as originally drafted deferred any effective date until 180 days. This was done to allow the utilities a reasonable period to obtain a ruling on eli-

gibility from the U.S. Internal Revenue Service. Ratepayer interest would have been protected by adequate accounting, refund, and interest provisions.

But today's majority strikes out that simple safeguard. In doing so they ignore the fact that last year's schemes, which the majority recklessly imposed on the state's largest electric utility and the state's largest gas utility, are in grave danger of causing millions of dollars in unnecessary tax liabilities to fall upon those companies. (See Majority and Minority Opinions: A. 54946 *Southern California Edison Company*, D. 86794, December 21, 1976; rehearing based on adverse tax attorney opinion, D. 87828, September 7, 1977; and A. 55676, *Southern California Gas Company*, D. 85627, March 30, 1976, together with adverse IRS ruling, dated November 22, 1976; California Supreme Court decision pending, in Case SF 23495.)

In light of these danger signals, it is imprudent of the Commission not to exhaust available consultive procedures and thus safeguard the state against the catastrophic consequences of ineligibility.

Instead, the majority lectures Congress on legislative goals. Acting as a school marm to Congress, the majority tells the national legislature that federal tax credits and deferrals may be used to lower monthly utility bills, but may not be used to stimulate job development or accelerated capital investment. Such homey advice is interesting but what the California ratepayer will have to worry about is the bottom line. What will he and the California utility companies have to pay to Washington, D.C., after the IRS has cut through the verbiage of this decision and applied the law?

San Francisco, California

September 13, 1977

/s/ WILLIAM SYMONS, JR.
WILLIAM SYMONS, JR.

COMMISSIONER VERNON L. STURGEON, Dissenting

The inconsistent and cavalier manner in which the majority treats the key issue of eligibility for accelerated depreciation warrants my strong dissent. The majority recognizes, as it must, that our regulatory treatment of accelerated depreciation and the investment tax credit (ITC) *must* preserve General's and Pacific's eligibility for these tax saving methods. The majority, in one of its few realistic comments on the question, states that:

> "Eligibility is the first issue to be determined. To render a decision which attempts to resolve these cases without regard for this issue might create problems for these utilities, their ratepayers, the Commission, and the Courts that even exceed (both in scope and complexity) the problems that we are attempting to resolve in this decision." (Mimeo p. 19)

After recognizing and elaborating upon the importance of eligibility, the majority then, incredibly, moves quickly to jeopardize that eligibility by adopting a regulatory accounting scheme whose compliance with the standards of normalization established by the Internal Revenue Code and Treasury Regulations *must* be considered a matter of speculation. While the majority states confidently (Finding No. 3) that "This method complies with Treasury Regulation 1.167(*l*)-(1)(h)(6) and is normalization accounting," they admit (at Mimeo p. 41) that "We have here a case of first impression under the tax laws . . ."

The Examiner's Proposed Report took a sensible approach to the eligibility question by setting an effective date 180 days after the entry of the order. Had a majority of the Commission had the wisdom to adopt such an approach, Pacific and General would have not only the time but the incentive to seek an expeditious IRS ruling. The majority correctly points that "expeditious" is not an adjective frequently associated with IRS rulings (as it is not with deci-

sions of this Commission). However, even if no such ruling were issued within the 180 days following the entry of the order, what harm would occur? Under the Examiner's approach, the order would simply be final at that time. If a ruling was issued, the Commission would then have the opportunity to modify the order if necessary.

It is doubtful that any of the majority would, in the handling of their own federal income taxes, make a decision involving a risk of substantial tax liability in which their position rested on a legal position which they knew to be a "case of first impression under the tax laws." Today, however, they have asked Pacific, General and their ratepayers to do just that.

/s/ VERNON L. STURGEON
VERNON L. STURGEON
Commissioner

San Francisco, California

September 13, 1977

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1979

No. 79-231

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY,
Petitioner,

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, and JOHN E. BRYSON, VERNON L. STURGEON, RICHARD D. GRAVELLE, CLAIRE T. DEDRICK and LEONARD M. GRIMES, JR., the members of said PUBLIC UTILITIES COMMISSION; W. MICHAEL BLUMENTHAL, Secretary of the Treasury, an agency of the United States of America; and JEROME KURTZ, Commissioner, Internal Revenue Service, an agency of the United States of America; CITY OF LOS ANGELES, a municipal corporation; CITY OF SAN DIEGO, a municipal corporation; CITY AND COUNTY OF SAN FRANCISCO, a municipal corporation; TOWARD UTILITY RATE NORMALIZATION,
Respondents.

No. 79-232

GENERAL TELEPHONE COMPANY OF CALIFORNIA,
A California corporation,
Petitioner,

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, et al.,
Respondents.

CITY OF LOS ANGELES, CITY OF SAN DIEGO, CITY AND COUNTY OF SAN FRANCISCO, TOWARD UTILITY RATE NORMALIZATION,
Intervenors.

ON PETITIONS FOR WRITS OF CERTIORARI OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR RESPONDENTS PUBLIC UTILITIES COMMISSION, CITY OF LOS ANGELES, CITY OF SAN DIEGO, AND CITY OF SAN FRANCISCO IN OPPOSITION

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BRIEF FOR RESPONDENTS PUBLIC UTILITIES COMMISSION, CITY OF LOS ANGELES, CITY OF SAN DIEGO, AND CITY OF SAN FRANCISCO IN OPPOSITION

INTRODUCTION

Respondent California Public Utilities Commission (Commission) and Respondents City of San Diego, City of Los Angeles and City and County of San Francisco (Cities) respectfully request this Court to deny the petitions of Pacific Telephone Company and General Telephone Company for writs of certiorari to review the decision of the United States Court of Appeals for the Ninth Circuit entered on July 18, 1979, upholding the district court's denial of a preliminary injunction in this matter. (*Pacific Telephone and Telegraph Company v. Public Utilities Commission*, Nos. 79-3150 and 79-3151, slip op. (CA 9, July 18, 1979) (Petitioner's Joint Appendix, pp. 1a-15a, cited hereinafter as Pet. App.)

OPINIONS BELOW

In addition to the opinions below contained in Pet. App., attached hereto as Respondents Appendix (hereinafter Res. App.), is the opinion of Mr. Justice Rehnquist, Circuit Justice, (*Pacific Telephone and Telegraph Co. v. Public Utilities Commission*, Nos. A-101 and A-102, slip op. (U.S. S. Ct., August 13, 1979).

STATEMENT OF THE CASE

A statement of the case is contained in the Ninth Circuit's opinion (see Pet. App. pp. 2a-4a) and Mr. Justice Rehnquist's opinion (see Res. App. pp. A-1 to A-6) and will not be repeated here. Mr. Justice Rehnquist summed up the status of this case by saying:

> The net of it is that I believe applicant's federal court litigation is new wine in old bottles. When it was new wine in new bottles, last Term, this Court denied certiorari, and I have no reason to believe that any intervening events would change that outcome. (Res. App. p. A-5)

QUESTION PRESENTED

Should the petitioners be allowed to collaterally attack in the federal courts a decision of the California Public Utilities Commission (Commission) after the California Supreme Court has denied a petition for writ of review, the United States Supreme Court has denied a petition for certiorari, a federal district court has denied a preliminary injunction based on the doctrine of res judicata, the Ninth Circuit Court of Appeals has affirmed the denial of the preliminary injunction of the district court and has denied petitioners' request for a stay of mandate in order that they might petition this Court for certiorari and Mr. Justice Rehnquist, Circuit Justice, has denied petitioners' request for a stay of the mandate of the Court of Appeals for the Ninth Circuit?

REASONS FOR DENYING THE WRIT

I

THE JUDGMENT BELOW IS IN AGREEMENT WITH DECISIONS OF THIS COURT AND WITH THE JUDGMENTS OF OTHER UNITED STATES COURTS OF APPEALS AND WITH THE RULINGS OF OTHER PANELS OF THE NINTH CIRCUIT COURT OF APPEALS

A. Petitioners Misstate the Question

Petitioners allege that:

> The sole question resolved below is that the Decision of the California Public Utilities Commission on the

question of Petitioner's federal tax liability must be treated as an estoppel against the consideration of that federal tax question in subsequent litigation in the appropriate federal district court.

(Pacific's petition, p. 8).

The Ninth Circuit made no such finding and, significantly, Pacific does not cite the opinion in making this claim. The Ninth Circuit's opinion is in no way inconsistent with any of the cases that have been cited by petitioners. Those cases involved attempts to block a federal action by asserting a state court decision as a bar to the federal action. However, in the present matter, petitioners do not seek a right to pursue a federal remedy; rather petitioners seek to *overturn a state decision*. The Ninth Circuit simply held that res judicata barred the latter; i.e., reversal of the state court decision. The state decision was held not to bar any action that petitioners might undertake in federal court under the federal tax laws or any actions the Internal Revenue Service may file in federal courts. The Ninth Circuit stated:

"Moreover, appellants will have an opportunity to present to the Federal Courts their contentions regarding the proper interpretation of federal tax statutes if and when the IRS seeks to collect the additional taxes. Additionally appellants may also have an opportunity to litigate those interpretations in their declaratory relief action . . ." (Pet. App. p. 152 (footnote 15))

The Ninth Circuit further stated:

"We need not determine, however, if later cases have eroded federal deference to state interpretations of federal questions. In the instant case appellants' constitutional claims are frivolous. *See* note 15 *infra*. And

the federal courts have not been asked in this proceeding for injunctive relief to interpret a federal statute. Appellants went to state court to have it overturn a state agency's rate order. Now they ask the federal courts to overturn the order. While appellants' underlying disagreement with the rate order is that the PUC allegedly misunderstood federal tax law (assuming that the IRS's interpretation is correct), whether this misunderstanding vitiates the rate order does not involve construction of a federal statute, but rather depends upon the scope of the PUC's discretion in setting rates. Cf. Napa Valley Electric Co. v. R.R. Comm'n, 251 U.S. 366, 372 (1920)." (Pet.App. p. 6a (footnote 6))

Here, the Ninth Circuit is recognizing, *inter alia*, the important distinction between the Commission rate case and a potential federal tax case, the distinction which petitioners fail to draw. Moreover, the key point, as recognized by the Ninth Circuit, is that the relief sought by petitioners is the overturning of the state court order and that relief *only* is barred by res judicata.

B. This Court's Decision

Petitioners attempt to rely on the recent decision of *Brown v. Felsen*, ... U.S. ....., 60 L.Ed.2d 767, 99 S.Ct. ....., (1979) for the proposition that the state court judgment is not binding on the federal courts. It is respectfully submitted that their reliance is misplaced. The Commission's decision determined intrastate rates for the petitioners and *Brown v. Felsen* supports the proposition that this rate order is final and binding. In *Brown v. Felsen*, Creditor wins a collection suit against Debtor in the state court. The suit was settled by stipulation which did not indicate

the cause of action on which Debtor's liability to Creditor was based (*Brown v. Felsen, supra,* ..... U.S. ....., 60 L.Ed.2d at 769). Debtor then filed a petition for voluntary bankruptcy in Federal Court and sought to have the debt to Creditor discharged. In Bankruptcy Court Creditor sought to establish that Debtor's debt was not dischargeable as it was the product of fraud, etc. and fell under Section 17a(2) and 17a(4) of the Bankruptcy Act. No one in *Brown v. Felsen* contested the fact that the state court decree establishing the debt was binding on all parties. The Court said:

> Here, in contrast, petitioner readily concedes the prior decree is binding. That is the cornerstone of his claim.
>
> *Brown v. Felsen, supra,* ..... U.S. ....., 60 L.Ed.2d at 772.

The basic distinction between this proceeding and *Brown v. Felsen* is that nobody was contesting the state court's judgment that Debtor owed Creditor some money. It was only after Debtor raised a new defense in the bankruptcy action, i.e., dischargeability, that it became necessary for Creditor to prove that the debt was not dischargeable under § 17. This had not been in issue in the state court case whereas here the issue of proper rates for petitioners was the issue in state court. Just as the establishment of the debt in *Brown v. Felsen* was accepted by the bankruptcy court the establishment of proper rates for petitioners should be accepted by this Court.

Similarly, the petitioners reliance on Mr. Justice Brennan's dissent in *Will v. Calvert Fire Ins. Co.*, 437 U.S. 655, 57 L.Ed.2d 504, 98 S.Ct. 2552 (1978) is misplaced. The

Commission's decision set intrastate telephone rates. It did not decide, in any manner which could be binding on the federal courts, the issue of petitioners federal income tax liability. Mr. Justice Brennan said:

> For myself, I confess to serious doubt that it is ever appropriate to accord res judicata effect to a state court determination of a claim over which the federal courts have exclusive jurisdiction . . .
>
> *Id.* at 674.

In this proceeding the state court did not determine a claim over which the federal courts have exclusive jurisdiction. The determination of whether or not the petitioners will be eligible or ineligible for federal tax benefits will be determined in the federal courts—that is the "determination of a claim." The Commission only found certain facts concerning the federal tax law which influenced it in its ratemaking determination.

Petitioners assert that the Commission's decision must fall by the wayside because of this Court's decision in *Montana v. United States,* ..... U.S. ....., 59 L.Ed.2d 210, 99 S.Ct. 920 (1979). In *Montana* a contractor for a federal project instituted an action in a state court to declare a state tax unconstitutional. The United States supported and directed the contractor's action. The United States also subsequently filed a federal district court suit asserting the same cause of action as the state suit. The Montana Supreme Court upheld the state tax. A three-judge district court heard the United State's case and held the tax unconstitutional. This court reversed on the grounds that the Government had a full and fair opportunity to press its consti-

tutional challenges in the state court and was therefore estopped from seeking a contrary resolution of those issues in the federal court (*Id.* at 59 L.Ed.2d 223-224).

The issue that was fully decided in the Comission's Decision was the proper ratemaking treatment of petitioners' federal income taxes. In *Montana* this Court said:

> "A fundamental precept of commonlaw adjudication, embodied in the related doctrines of collateral estoppel and res judicata, is that a "right, question or fact distinctly put in issue and directly determined by a court of competent jurisdiction . . . cannot be disputed in a subsequent suit between the same parties or their privies. . . ." Southern Pacific R. Co. v. United States, 168 US 1, 48-49, 42 L.Ed. 355, 18 S.Ct 18 (1897). Under res judicata, a final judgment on the merits bars further claims by parties or their privies based on the same cause of action. Cromwell v. County of Sac., 94 US 351, 352, 24 L.Ed. 195 (1877); Lawlor v. National Screen Service Corp. 349 US 322, 326, 99 L.Ed. 1122, 75 S.Ct. 865 (1955); 1B J. Moore, Federal Practice ¶ 04.05. [1], at 621-624 (2d ed 1974); Restatement (Second) of Judgments § 47 (Tent Draft No. 1, March 28, 1973) (merger); Id., § 48 (bar)."
>
> *Id.* at 59 L.Ed.2d 216-217.

The Court further explained the reasons for the doctrines of res judicata and collateral estoppel:

> ". . . Application of both doctrines is central to the purpose for which civil courts have been established, the conclusive resolution of disputes within their jurisdictions. Southern Pacific Railroad, supra, at 49, 42 L.ed 355, 18 S.Ct. 18; Hart Steel Co. v. Railroad Supply Co. 244 US 294, 299, 61 L.E. 1148, 37 S.Ct. 506 (1917). To preclude parties from contesting matters that they have had a full and fair opportunity to litigate protects their adversaries from the expense and vexation attending multiple lawsuits, conserves judicial resources, and fosters reliance on judicial action my minimizing the possibility of inconsistent decisions. [fn. omitted.]"

In addition to the doctrine of repose the Court said:

> "Considerations of comity as well as repose militate against redetermination of issues in a federal forum at the behest of a plaintiff who has chosen to litigate them in state court."
>
> *Id.* at 59 L.Ed. 2d 223.

It is respectfully submitted that petitioners have had their day in court and the petitions for writs of certiorari should be denied.

C. Lower Federal Court Decisions

It is for this same reason that the lower federal court decisions cited by petitioners are inapposite. *Lyons v. Westinghouse Electric Corp.*, 222 F.2d 184 (2d Cir. 1955), *cert. denied*, 350 U.S. 825 (1955) and *Cream Top Creamery v. Dean Milk Co.*, 383 F.2d 358 (6th Cir. 1967) are cases concerning anti-trust actions and the relationship between federal and state courts in that context. *American Mannex Corp. v. Rozands*, 462 F.2d 688 (5th Cir. 1972), *cert. denied*, 409 U.S. 1040 (1972) was a case in which taxpayers sued in federal district court to contest the imposition of a Louisiana state ad valorem tax on certain of their property. The same taxpayers had contested in state court the levy of the same tax on the same property, raising the same con-

stitutional objection (*id.* at 689). The district court held that the federal suit was barred by the earlier state court determination of the constitutional issue between the same parties and the Fifth Circuit Court of Appeals agreed (*ibid.*). The Court said:

> "When the parties and the cause of action litigated are the same in state court as in federal court, the doctrine of res judicata has been held to bar federal relitigation, even if a federal constitutional question is in dispute [citations omitted]. Similarly, it has been held that disputed factual or legal issues arising between the same parties cannot be relitigated in federal court after a valid state court determination of the same issues."
>
> *Id.* at 690.

These petitions for certiorari are simply an effort to relitigate issues which have been determined adversely to petitioners by the administrative and judicial processes of the State of California, and with regard to which this Court denied certiorari and denied rehearing last Term. 439 U.S. 1052 (1978); 440 U.S. 931 (1979). (*Pacific Telephone & Telegraph Co. v. Public Utilities Commission,* Nos. A-101 and A-102, slip op. at 3, (U.S. S.Ct., August 13, 1979) (Res. App., p. 2a)).

In re Houtman, 568 F.2d 651 (9th Cir. 1978) is a bankruptcy case concerning the proper court to determine dischargeability of debts. The same arguments presented concerning *Brown v. Felsen, supra,* are applicable to *In re Houtman* and will not be repeated here.

Red Fox v. Red Fox, 564 F.2d 361 (9th Cir. 1977) was a case concerning whether David Red Fox had his rights

under the Indian Civil Rights Act (25 U.S.C. § 1302(8)) violated. A tribal court had granted his wife a default decree of divorce and the Oregon state courts had held that the tribal court decree was entitled to recognition. The Federal District Court held that the federal action instituted by David was barred by the principles of res judicata and collateral estoppel inasmuch as the federal action necessarily involved the same issues as had been litigated and resolved against David in the Oregon courts (*Id.* at 363).

It is respectfully submitted that none of the above cases, cited by petitioners, are at variance with the decisions below of the District Court and the Ninth Circuit.

II

UNDER THE CALIFORNIA CONSTITUTION THE PRIOR ACTION OF THE CALIFORNIA COURT IS ENTITLED TO RES JUDICATA EFFECT

The continued vitality of *Napa Valley Electric Co. v. Railroad Commission,* 251 U.S. 366 (1970) which held that, under California law, the California Supreme Court's denial of writs of review of rate decisions constitute a denial on the merits is fully discussed by the Ninth Circuit in *Pacific Telephone & Telegraph Co. v. Public Utilities Commission,* No. 79-3150, slip. op. at 4-10, (CA9, July 18, 1979) (Pet App. pp. 4A-15A). Mr. Justice Rehnquist, as Circuit Justice held that:

> "If I thought it necessary in passing upon this stay application to determine the present day correctness of this Court's reading of California law in *Napa Val-*

ley Co. v. Railroad Commission, 251 U.S. 366 (1920), I would naturally defer to the opinion of the Court of Appeals, which must deal with California law more frequently than does this Court."

Pacific Telephone & Telegraph Co. v. Public Utilities Commission, Nos. A-101 and A-102, slip op. at 4 (U.S. S.Ct., August 13, 1979) (Res. App. p. A-4).

It is respectfully submitted that the Ninth Circuit's reading of California law is correct and that no basis exists for issuing a preliminary injunction.

CONCLUSION

Respondents have not addressed various of the arguments of petitioners in depth. We respectfully refer to the opinion of the Ninth Circuit and the opinion of Mr. Justice Rehnquist, which are included in this record, and the joint Opposition To Application For Temporary Stay Of Decision Of The Court Of Appeals For The Ninth Circuit Pending Application For Certiorari filed by respondents before this Court in Nos. A-101 and A-102. We also respectfully refer to further discussion of various of petitioners' arguments in the following pleadings filed before this Court in Nos. 78-606 and 78-607, the proceedings wherein petitioners unsuccessfully sought review of respondent Commission's decision in the October, 1978 Term: Brief For Respondent Public Utilities Commission In Opposition, Brief In Opposition To Petitions For Writ Of Certiorari filed by respondent Cities, and Reply to Memorandum For The United States As Amicus Curiae, filed by respondent Cities.

For the reasons herein stated, it is respectfully submitted that certiorari should be denied.

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(Appendix Follows)

APPENDIX

APPENDIX

Supreme Court of the United States

Nos. A-101 and A-102

Pacific Telephone & Telegraph Co.,
Petitioner,

A-101 v.

Public Utilities Commission of
California et al.

General Telephone Co.,
Petitioner,

A-102 v.

Public Utilities Commission of
California et al.

On Applications for Stay.

[August 13, 1979]

MR. JUSTICE REHNQUIST, Circuit Justice.

Applicants request that I continue in effect a temporary injunction issued by the Court of Appeals for the Ninth Circuit on April 2, 1979, pending disposition by the full Court of their petitions for certiorari to review the judgment of the Court of Appeals. On July 18 that court, in a consolidated case in which both applicants were appellants, affirmed the judgment of the United States District Court for the Northern District of California denying applicants' injunctive relief against the enforcement of a rate order earlier promulgated by respondent California Public Utility Commission (PUC). The PUC in September 1977

(Decision No. 87838), had ordered applicants to refund charges paid by subscribers before 1978 and to reduce certain of its rates for that and future years. The PUC, however, stayed implementation of its order pending judicial review. *Pacific Telephone & Telegraph Co. v. Public Utilities Comm'n,* No. 79-3150, slip. op., at 2 (CA9, July 18, 1979).

After the Supreme Court of California denied applicants' request for review, applicants petitioned this Court for certiorari. Applicants argued this Court should review the PUC rate order because it was premised on the PUC's interpretation of an unsettled question of federal tax law. They claimed that if this interpretation subsequently proved incorrect, they would be subject to substantial liability in back taxes. Applicant Pacific Telephone also challenged the PUC's decision on the ground that it violated the Due Process Clause. The petitions were denied on December 12, 1978. 439 U. S. 1052, with MR. JUSTICE MARSHALL and MR. JUSTICE BLACKMUN dissenting from the order of denial. Petitions for rehearing were thereafter denied on February 21, 1979, 440 U. S. 931. On March 14, 1979, the PUC terminated the stay of its own order of September 13, 1977, stating in its order so doing that "the avenues of judicial review have been exhausted." *Pacific Telephone & Telegraph Co., supra,* slip op. at 2. The following day applicants filed a complaint for declaratory and injunctive relief in the United States District Court for the Northern District of California. That court denied relief, but the Court of Appeals granted its own temporary injunction on April 2, 1979, pending consideration of applicants' appeal from the order of the District Court. Last month, as previously

noted in this opinion, the Court of Appeals affirmed the judgment of the District Court, dissolved its own injunction, and denied applicants' request for a stay of mandate in order that they might petition this Court for certiorari.

With this sort of procedural history, one would expect applicants' petitions for certiorari to deal principally with questions arising under the United States Constitution or laws governing the setting of rates by state utility commissions for public utilities. But the questions which applicants seek to have reviewed on certiorari pertain to the application of federal tax statutes as they relate to depreciation which may be claimed by public utilities. Since it is this type of question which applicants seek to litigate if certiorari is granted, one would likewise expect either an agency or officer of the United States having some responsibility for administering these tax statutes named as respondents, instead of the California PUC or intervening California municipal corporations. Without dwelling further on the anomalous nature of applicants' petitions for certiorari, I have concluded that their actions in the United States District Court for the Northern District of California begun in March 1979, were simply an effort to relitigate issues which had been determined adversely to them by the administrative and judicial processes of the State of California, and with regard to which this Court denied certiorari and denied rehearing last Term. 439 U. S. 1052 (1978); 440 U.S. 931 (1979). These denials took place notwithstanding the fact that the Solicitor General urged the Court to grant certiorari and decide the issues presented by the petitions.

The PUC in its Decision No. 90094, rendered on March 14, 1979, after the proceedings in this Court, was doing no more than formally stating that the conditions on which its stay had been granted—exhaustion of judicial review—had occurred, and therefore the stay expired by its own terms. The PUC dissolved this stay despite applicants' contention that the PUC's interpretation of federal tax law in Decision No. 87838 was incorrect and that the rate order would consequently result in the IRS's assessment of substantial tax deficiencies against applicants. In my opinion, the determination of whether or not the PUC's rate order should have been stayed pending resolution of the federal tax issues was, at this late stage in the proceedings, entirely a matter for the State to decide.

One need not question the assertion of applicants that very large financial stakes hinge on the manner in which the IRS, subject to whatever review of its action is provided by law, treats the refund and rate reduction orders imposed by the PUC's order of September 13, 1977. Nor need one doubt that this Court had jurisdiction, under cases such as *Zacchini v. Scripps-Howard Broadcasting Co.*, 433 U. S. 562 (1977), to review applicants' earlier petitions for certiorari in Nos. 78-606 and 78-607, O. T. 1978, on the ground that the PUC had reached a decision based on a misapprehension of federal law which it might not have reached had it correctly understood federal law. But that is now water over the dam. This Court denied those petitions last Term, and denied petitions for rehearing.

If I thought it necessary in passing upon this stay application to determine the present day correctness of

this Court's reading of California law in *Napa Valley Co.* v. *Railroad Commission*, 251 U. S. 366 (1920), I would naturally defer to the opinion of the Court of Appeals, which must deal with California law more frequently than does this Court. But I do not actually think it is necessary to make this determination; a State may enunciate policy through an administrative agency, as well as through its courts, and so long as there is an opportunity for judicial review the fact that such review may be denied on a discretionary basis does not make the agency's action any less the voice of the State for purposes of this Court's jurisdiction or for purposes of federal-state comity. See *United States* v. *Utah Construction Co.*, 384 U. S. 394, 419-423 (1966). Nor is this a case where any claim of bias is made against the agency, see *Gibson* v. *Berryhill*, 411 U. S. 564 (1973), or where an action of the federal court's in refusing to allow applicants to relitigate the merits of their claim on which this Court has previously denied certiorari amounted to the imposition of a requirement of "exhaustion of administrative remedies." Here the administrative action was the source of the claimed wrong, not a possible avenue for its redress.

The net of it is that I believe applicants' federal court litigation is new wine in old bottles. When it was new wine in new bottles, last Term, this Court denied certiorari, and I have no reason to believe that any intervening events would change that outcome. Accordingly, without considering the second part of the requirement which applicants must meet in order to obtain a stay—the so-called "stay equities"—the temporary stay which I previously issued

is dissolved forthwith, and applicants' request for a stay of the mandate of the Court of Appeals for the Ninth Circuit is hereby

Denied.

Dated in Washington, D. C. this
13th day of August, 1979.

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1979

Nos. 79-231 and 79-232

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, GENERAL TELEPHONE COMPANY OF CALIFORNIA,

Petitioners,

THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, et. al.,

Respondents.

BRIEF OF INTERVENOR TOWARD UTILITY RATE NORMALIZATION (TURN) IN OPPOSITION TO PETITIONS FOR WRIT OF CERTIORARI

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INTRODUCTION

The instant proceeding is another effort by Pacific Telephone (Pacific) and General Telephone (General) to reap the benefits of revenues collected improperly. The entire factual history of the case was presented in prior petitions for Writs of Certiorari [Pacific Telephone & Tel. Co. v. PUC, U.S. Supreme Ct. Docket No. 78-606, 78-607, _____U.S.____, 58 L.Ed.2d. 713 (1978)]. As indicated in our brief in that case, petitioners are public utilities which were required by the California Supreme Court to rebate to the California ratepayers funds collected, but not used, for Federal Income taxes. Although the amount of the money collected exceeds one billion dollars, the instant decision orders only approximately 25% returned to the ratepayers (California Public Utility Commn Dec. 87838). Petitioners will be permitted to retain the balance of the improperly collected taxes. Seldom has a regulated public utility been

as handsomely rewarded for activities which were characterized by the California Supreme Court as representing examples of "imprudent management".

The procedural history of this case is set out in the opinion of Mr. Justice Rehnquist denying petitioner's application for stay (Pacific Telephone & Tel. Co., et. al. v. PUC., et al. (A-101 and A-102) August 13, 1979 _____U.S._____).

Petitioners allege that the Commission's Decision No. 87838, which ordered the partial refunds, will have adverse tax consequences. They seek a declaratory judgment and an advisory opinion from the Federal Court for the purpose of resolving this tax controversy. As petitioners correctly note in their statement of facts, the entire action was considered by this Court in 1978 (Pacific Telephone & Tel. Co. v. PUC, Docket Nos. 78-606, 78-607, supra.

TURN was a party in the prior proceedings, as well as in these proceedings.

Since there is substantial overlap in the issues presented by the two proceedings, we are incorporating our prior brief in the instant action.

INTEREST OF TURN

TURN is a non-profit California corporation which represents the interests of residential and small business customers of utilities such as petitioners. Our Board of Directors consist of people representing consumer groups, small business interests, and those concerned with the needs of our disadvantaged citizens.

It has been our position throughout the administrative and judical phases of this litigation that Petitioners are entitled to full reimbursement for their reasonable expenses of operation. This includes reimbursement for their actual income tax expenses and reasonable depreciation expenses as computed in a reasonably prudent manner.

TURN has actively participated in the original hearings before the California Public Utilities Commission. As a party to those proceedings, we also actively participatedin the administrative and judicial appeals in California, and to this Court (Pacific Telephone & Tel. Co., et. al. v. PUC, et. al., Docket No. 78-606 and 78-607, ____U.S.___, 58 L. Ed.2d. 713 (1978), Writ Denied, Dec. 11, 1978, rehearing denied, Feb. 21, 1979).

TURN's interest in preventing petitioners from retaining funds collected through imprudent management, has required us to intervene in the further litigation brought in the United States District Court for the Central District of California. In this regard, it bears noting that petitioners have deliberately chosen an inconvenient forum to pursue this litigation. The entire prior proceedings, both administratively and judicially, occurred in the Northern District of Calif-

ornia. Thus, all parties had retained Northern California counsel and expected the litigation to remain in this forum. Unaccountably, petitioners sought to discourage effective oppostiion by bringing the present action in Los Angeles [See Joint Appendix 17a, 21a; Cf Pacific Telephone & Tel. Co. v. PUC, Docket Nos. A-101 and A-102 ____U.S.____Opinion of Mr. Justice Rehnquist, Aug. 13, 1979]. Despite the inconvenient nature of this forum, all parties incurred the additional expenses needed to resolve the matter in Los Angeles rather than permit appellants additional delays. We believe that this petition should be quickly denied, and that all of the disputed funds promptly be distributed in a lump sum check to the affected California ratepayers.

JURISDICTION

This Court should not assume jurisdiction in this matter since Pacific raised issues not presented at earlier

stages of the litigation. Both petitioners received a full and fair review by this Court, as well as the California Supreme Court in 1978 when they brought the prior petitions for Writs of Certiorari (Pacific Telephone & Tel. Co., et. al., v. PUC, et. al., Docket Nos. 78-606 and 78-607, supra). We urge this Court to adopt the reasoning and views regarding this matter stated by Mr. Justice Rehnquist in his opinion denying the applications of appellants for a stay of the decision [Pacific Telephone & Tel., Co., et. al. v. PUC, (Docket Nos. A-101 and A-102, Aug. 13, 1979].

QUESTIONS PRESENTED

1) Are appellants barred from relitigating in Federal Court the merits of the Commission's Decision No. 87838?

2) May Pacific raise a question regarding Article VI, §14 of the California Constitution for the first time on this appeal?

3) What is the appropriate disposition

for this cause?

ARGUMENT

I

THE MERITS OF DECISION 87838, AND THE ALLEGED CONFLICT BETWEEN THAT DECISION AND FEDERAL TAX LAWS ARE NOT PROPERLY BEFORE THIS COURT

A. The Proper Treatment of Decision No. 87838 for Purposes of Federal Income Tax Laws is not Before This Court.

The decision which petitioners seek to enjoin arose from an interstate rate-making proceeding before the California Public Utilities Commission. Even petitioners recognize that the instant decision was a correct application of California Law. However, they argue for a declaratory judgment regarding the Federal Income Tax effects of that decision. This precise argument was presented in their prior petition for Writs of Certiorari from this Court. At pages 31 through 39 of our brief in response to that petition, we domonstrated the substantive errors in Petitioner's view of the Federal Tax Law. Pages 24 through 31, of that prior brief, argued

that this Court is precluded from rendering an advisory opinion in the nature of declaratory relief as requested by petitioners. Those arguments will not be repeated in this brief, but are incorporated by reference [Pacific Telephone & Tel. Co. v. PUC, (TURN Br. Nov. 1978, U.S. Supreme Court, Docket Nos. 78-606, 78-607)].

A taxpayer's desire to secure a binding resolution of a Federal Tax controversy, before committing himself, is hardly a unique situation. Often, the rules of an administrative agency make it difficult for taxpayers to avoid payment of taxes, or to secure certain tax benefits. Congress recently responded to the cries of the injured taxpayers by providing for limited declaratory judgments in order to resolve these controversies. These provisions are contained in Internal Revenue Code §7428. The procedural problems are discussed in cases such as in Animal Protection Institute Inc. v. United States, 78-2 USTC

¶9707 (Ct. Cl 1978). A brief review of this section reveals that it has no applicability whatsoever to the instant controversy. The provisions allow a non-profit organization which has secured its status from a state administrative agency to secure declaratory relief regarding an adverse Internal Revenue Service decision denying tax benefits to which the organization believes itself entitled. Thus Congress was aware of the problem confronting taxpayers, and specifically afforded an early remedy in those circumstances which warrant it. As pointed out in our prior brief, there are no good reasons for this Court to provide a declaratory relief remedy for these taxpayers which Congress omitted for other similarly situated taxpayers.

B. The Anti-Injunction Statute (28 U.S.C. §2283) Precludes the Requested Relief.

The scope of review for decisions of the Commission is exceedingly narrow. Traditionally, the Commission is presumed

to have dealt fairly with public utilities in fixing rates, and Federal Courts will not interfere absent a blatant confiscation of utilities' property (Los Angeles Gas & Electric v. CRC, 58 F.2d. 256 (DCC 1932, Aff'd. 289 U.S. 287; Ashbury Truck Company v. CRC, 58 F.2d. 263 (DCC 1931) Aff'd. 287 U.S. 570). The narrow scope of this review was emphasised by Congress in passing the anti-injunction statute. That Statute reads as follows:

> "A court of the United States may not grant an injunction to stay proceedings in a state court except as expressly authorized by Congress or where necessary in aid of its jurisdiction, or to protect or affectuate its judgments." (28 U.S.C. 2283).

This statute has been specifically applied to cases such as the instant one [Oklahoma Packing Company v. Oklahoma Gas and Electric Company (1940) 309 U.S. 4]. In this case, the utility appealed to the Oklahoma Supreme Court from an order reducing its rates. That order was stayed

by the State Commission pending appeal. After the utility lost the appeal in the state court, it sought an injunction in the Federal Court. The United States Supreme Court dissolved the injunction on the theory that it was issued in excess of the provisions in the anti-injunction statute quoted above.

The effect of this statute cannot be avoided merely by framing the complaint in terms of declaratory relief, or seeking to restrain a non-judicial agency such as the regulatory commission instead of the state itself [Oklahoma Packing Company v. Oklahoma Gas & Electric Company, supra, Hill v. Martin (1935) 296 U.S. 393, N. 113; H. J. Heinz v. Owens (1951 C.A. 9th) 189 F.2d. 505, Reh. Den. 191 F.2d. 257, Cert. Den. 1952, 343 U.S. 905; City of Miami v. Sutton (1950) C.A. 5th, 181 F.2d. 644, 649].

C. The Doctrine of Res Judicata Applies to Bar the Present Suit.

Throughout both of appellant's petitions before this Court, they have argued that there is a conflict between the Internal Revenue Service and the California Public Utilities Commission regarding the appropriate interpretation of certain provisions of Federal Tax Law. The controversy has been simmering for over a decade. Nevertheless, neither petitioner chose to actually litigate the issue in the Tax Court, United States District Court or the Court of Claims in the manner provided for resolution of tax controversies. Instead, both utilities sought to litigate the issue before the Commission and the California Supreme Court. Three times the California Supreme Court considered the arguments and wrote unanimous opinions. These opinions explained that petitioners were guilty of imprudent management, and should be treated similarly to other utilities regarding these tax matters. Thus petitioners were required to take advantage of accelerated

depreciation and other provisions of the tax law. [City and County of San Francisco v. PUC (1971) 6 Cal.3d. 119, 130, 98 Cal. Rptr. 292; City of Los Angeles v. PUC (1972) 7 Cal.3d. 331, 102 Cal. Rptr. 313; City of Los Angeles v. PUC (1975) 15 Cal. 3d. 680, 125 Cal. Rptr. 779]. Finally, the instant decision was rendered, and appealed to the California Supreme Court. Having spoken three times previously, the Court denied the petition without further arguments or opinion. However, this denial still constituted an opinion on the merits and has res judicata effect [People v. Western Airlines (1954) 42 Cal.2d. 621, 269 P.2d. 723 (1954) Reh. Den., Appeal dismissed 348 U.S. 859. See also Napa Valley Electric Company v. Railroad Commission 251 U.S. 366 (1920); Francisco Enterprises, Inc. v. Kirby (9th 1970) 342 F.2d. 481].

The recent case of Montana v. United States, supra, (1979) ____U.S.____ 99 S.Ct. 970, 39 CCH S.Ct. Bull B. 995,

does not limit the scope of these principles. Montana v. United States, supra, involved the constitutionality of a one percent gross receipts tax upon the revenue of public contractors, which was not imposed upon private construction projects. At the insistance of the United States Government, one of its contractors brought a suit in the state court to contest the validity of that tax. After losing in the state court, the contractor then appealed to the United States Supreme Court. He then dismissed the appeal prior to a decision by this Court, and commenced a new action in the United States District Court making essentially the same argument regarding the invalidity of the tax. This Court reversed the decision of the District Court and held that the government was estopped by the prior resolution of the controversy in the Montana Supreme Court.

Our case presents an even stronger

claim for the application of estoppel since precisely the same parties are involved in both the state and Federal litigation, and no new issues or changes in the law are presented in the subsequent Federal case. Finally, in our case, the petitioners carried their petition for a Writ of Certiorari to this Court as well as seeking a rehearing after this Court denied the Writ. In contrast, the contractor in Montana v. United States supra, abandoned his appeal before receiving the decision of this Court. Similarly, neither of the present petitioners alleged the unfairness of the states procedures to which they voluntarily submitted and neither party contends that there were any changes in the controlling legal principles between this litigation in the state courts and the first petition to this Court, and the instant petition.

Likewise, the case of Brown v. Felson (1979) ___U.S.___ 60 L.Ed.2d. 767, 39

CCH S. Ct. Bull B. 2838 is of little comfort to petitioners. In that case, this Court found that a creditor in a collection proceeding filed in the state court, has little incentive to litigate bankruptcy issues which must be resolved in the Federal Court under §17 of the Bankruptcy Act. Consequently, the prior proceedings in the state court were not considered a bar to the receipt of further evidence in Federal Court. In contrast, all of the issues being considered in these Federal proceedings were vigorously presented on numerous occasions to the Commission and to the California Suprreme Court. In addition, the issues were presented for a decision to this Court last year (Pacific Telephone & Tel. Co. et. al. v. PUC, et. al. 78-606 and 78-707, supra.

Also, the debtor was required to actually be adjudicated a bankrupt before he could avail himself of the Federal

forum in Brown v. Felson, supra. In contrast, petitioners seek a resolution of their tax problems in the Federal Court without incurring any adverse consequences, whatsoever. They refuse to pay the refunds ordered by the state court, the Commission; and similarly refuse to pay the United States Government the taxes allegedly due. They truly seek to eat their cake and have it too.

II

PACIFIC RAISES A NEW ISSUE REGARDING THE CALIFORNIA CONSTITUTION ARTICLE VI, §14 WHICH WAS NOT PRESENTED PREVIOUSLY TO CALIFORNIA COURTS.

In its present petition for Writ of Certiorari, Pacific argues that the California Supreme Court had a duty to render a written opinion stating its reasons for denying the Writ of Review. In support of this position, it cites Article VI, §14 of the California Constitution. It should be noted that Pacific's prior citations to Article VI

were to the United States constiutional provision generally known as the Supremecy Clause. A review of the briefs reveals that the California Constitutional provision in Article VI, §14 has not been previously considered. If Pacific desired the consideration of that point, it should have filed a petition for rehearing in the California Supreme Court pursuant to Rule 27, California Rules of Court. This Rule gives the California Supreme Court the power to grant a rehearing after its own decision providing an appropriate petition is filed within 15 days after the filing of the decision. No such petition for rehearing was filed in the instant case.

When the California Supreme Court denied Pacific's petition for Writ of Review, it knew that no reasons were stated (See Joint Appendix, page 71a). Arguably, Pacific first learned that no reasons would be stated for the denial

of its petition when it received that document in the mail. However, had it filed for a rehearing, it could have raised this new point for consideration of the state Court. California Law permits the appellate courts to grant a petition for rehearing to consider the applicability of a new point not raised in the original petition (Traders and General Ins. Co. v. Pacific Employers Ins. Co. (1955) 130 Cal. Ap.2d. 158, 278 P.2d. 493).

Afart from this procedural problem, Pacific erroneously construes the meaning of this provision in the California Constitution. In fact, the denial of a petition without stating reasons is the normal California practice, and has the effect of binding the parties. For example, the recent criminal case of People v. Carrington 40 Cal.Ap. 647, 115 Cal. Rptr. 294 and appellant raised the issue of Article VI, §14 of the

California Constitution. The Court responded as follows:

> "An appellate court's denial without opinion of a petition for a writ of mandate is not a determination of a "cause" as the term is used in the Constitution. Only when the Appellate Court issues an alternative writ or order to show cause does the matter become a "cause" which is placed on the court's calendar for argument and which must be decided in writing with reasons stated. (People v. Medina, supra, 6 Cal.3d. at 490, 99 Cal. Rptr. at 633, 492 P.2d. at 689). But a decision, in common usage, is a determination arrived at after consideration (Webster's 3rd New International Dictionary (1965). A denial of a writ petition, without an opinion, is a decision for other purposes...". People v. Carrington 40 Cal.Ap. 647 at 650, 115 Cal. Rptr. 294 at 297.

In the instant case, the Petition for a Writ of Review of Pacific did not become a "cause" on the docket of the California Supreme Court because the matter was disposed of by a summary denial. Nevertheless, as provided by Rule 24 of the California Rules of Court,

it still became a binding decision of the California Supreme Court.

CONCLUSION

Throughout the tortured history of this case, the proceedings were held in San Francisco. All parties have counsel in San Francisco, and all parties were litigating this matter for many years in San Francisco. However, after this Court denied its petition for certiorari in 1978, petitioners unaccountably chose to move the dispute to Los Angeles. This had the effect of increasing the expense for the respondents, and allowing petitioners the luxury of forum shopping. Even Justice Rehnquist failed to notice this subtle switch in forums [CF Slip Op. August 13, 1979 denying the applications for stay U.S. Supreme Court Docket A-101 and A-102]. In view of the large benefits which accrue to petitioners from delaying the proceedings, we chose not to seek a change of venue. However, the cause presents a classic situation for

the application of the doctrine of Forum Non Conveniens [See James, Fleming Jr., Civil Procedure (1965) and cases cited at §12.17 r. 661]. It is noteworthy that TURN is the only organization directly affected by these increased costs since we are a private organization. In contrast, the petitioners can shift the burden to the ratepayers, and the other respondents may shift the increase to the taxpayers. We look forward to some relief from the burden imposed upon us by this unjustified switch of forums.[1]

The current decision requires the refund of only a small portion of the phantom taxes improperly retained by

[1] TURN recognizes that the other respondents may also be entitled to attorney's fees or other relief from petitioners for these actions. After the refunds have been made, the District Court can consider our motion for attorney's fees and other relief, as well as any such motions of the other parties.

* * * *

petitioners.

It is TURN's position that the Commission erred by failing to order the return of all these phantom taxes to the ratepayers. We recognize that a fourth of a loaf is better than none. For this reason, we urgedthis Court to deny the petitions for Writ of Certiorari when filed in 1978. All of those reasons still pertain to the instant proceedings. The only change in circumstances is that petitioners have secured free use of approximately one billion dollars in ratepayers' money without the requirement that the ratepayers be properly compensated for this privilege.

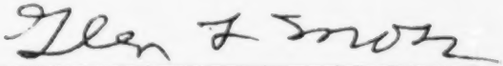
For the reasons stated in this brief, as well as in our prior brief in Docket Nos. 78-606 and 78-607, the Writs of Certiorari should be denied. However, this relief will not end the controversy since the underlying complaint is not fully consolidated with

this petition. We request that this Court transfer the matter to the United States District Court for Northern California with directions for that Court to dismiss the complaint with prejudice.

Respectfully Submitted:

Executed at Hayward California on September 7, 1979.

Edward M. Goebel, Esq.
Glen L. Moss, Esq.

by 
GLEN L. MOSS

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